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# NAVAL POSTGRADUATE SCHOOL

## Monterey, California



# THESIS

INTERNAL AUDITING TECHNIQUES UTILIZED  
AT THE COUNTY AND MUNICIPAL LEVELS OF  
GOVERNMENT IN THE STATE OF CALIFORNIA

by

James M. Dykes

June 1982

Thesis Advisor: R.A. Bobulinski

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Internal Auditing Techniques Utilized at the County and  
Municipal Level of Government in the State of California

by

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Submitted in partial fulfillment of the  
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT  
from the  
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June 1982



## ABSTRACT

This thesis presents an analysis of Internal Auditing at the County and Municipal levels of government in the State of California. Specifically, the research addresses the degree of local government's compliance with the expanded scope audit standards issued by the United States General Accounting Office (GAO) in 1972 and revised in 1981. The research encompasses specific aspects of the organization and independence, the professional skills, the audit performance and the reporting procedures of local level government audit offices. The information relevant to these areas was gathered by an author developed questionnaire. The response data provided is used to assess the degree of compliance with the GAO Standards and also to ascertain, if applicable, why local governments do not comply with these procedures. Conclusions and recommendations pertaining to this objective, as well as to the potential growth and development of internal auditing, are also provided.



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## I. INTRODUCTION

### A. GENERAL

Prior to 1972, governmental internal auditing encompassed a financial assessment of an entity to insure fiscal accountability and compliance. The process of internal auditing was defined as having one or more of the following purposes:

1. To ascertain whether the statements prepared from the accounts fairly presented the financial position and results of financial operations of the governmental unit in accordance with generally accepted accounting principles;
2. To determine the propriety, legality and mathematical accuracy of a governmental unit's financial transactions;
3. To ascertain whether all financial transactions have been properly recorded; and
4. To ascertain the stewardship of public officials who handle and are responsible for financial resources of a governmental unit. [1:127]

To supplement these purposes, the American Institute of Certified Public Accountants (AICPA), through its Committee on Auditing Procedures, developed and promulgated a set of generally accepted auditing standards designed to specify the level of quality expected in governmental audit work. These standards, categorized into those of a general nature, those applicable to field work and those pertaining to reporting procedures are listed in Appendix A. For the purpose of future comparison, the general standards issued in 1963 were as follows:

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor;
2. In all matters relating to the assignment, an independent mental attitude is to be maintained by the auditor or auditors, and



3. Due professional care is to be exercised in the performance of the examination and the preparation of the report. [1:128]

Since the standards were issued, the auditing profession has applied them as measures of the quality of work required in the performance of financial and compliance audits. [1:127] Thus, they were utilized to certify the fairness of financial statements presented by public sector organizations.

Literature indicates, however, that the concerns of legislators went beyond financial and compliance needs. Government management officials, as well as the general public, became interested in more than financial accountability; they were also interested in determining if government was achieving its goals within the parameters of law in an efficient and economical manner. [2:38] Thus, the role of the internal auditor in providing the timely, relevant and accurate data required to assess the totality of government operations was becoming of paramount importance. This observation was expressed in the following remarks of Ellsworth H. Morse, Jr., Assistant Comptroller General of the United States:

"Government programs and operations are big business and governmental expenditures are absorbing an ever increasing share of our national income. Government managers need all the help they can get to do an effective job.

"Public Accountants have skills that can be adapted to improving the efficiency, economy and effectiveness with which government operations are conducted. However, they need some sharpening to be more directly helpful to government managers and policy makers.

"Government programs and their objectives are complex and they are conceived, financed and administered in a political environment. While there are some similarities, the framework of operations differs greatly from that of private enterprise. This means that if public accountants are to effectively contribute to better government, they must invest some effort in acquiring the necessary knowledge and skills to deliver what is wanted and what is needed". [3:20-21]





The concept of internal auditing envisioned by the forward looking General Accounting Office (GAO) was that of an independent organization installed within the various levels of government to not only review financial statements, but also to aid management in the achievement of its goals by including a consideration as to the effectiveness of control systems and related administrative practices.

In a speech given before the Northwest Graduate Accounting Study Conference in the fall of 1970, Ellsworth H. Morse, Jr., then Director of the Office of Policy and Special Studies at the GAO, stated:

"Financial auditing requires the auditor to concern himself with many aspects of management or administrative performance and control. He cannot confine his attention to accounting records. The auditor of financial statements will find himself on much the same ground as the so called operational auditor". [4:41]

To meet the public sector's need, the GAO issued a new set of standards in 1972 designed to expand the scope of governmental auditing beyond concern with strictly financial activities and operations. As stated by Elmer B. Staats, former Comptroller General of the United States:

"Governmental auditing now is also concerned with whether governmental organizations are achieving the purposes for which programs are authorized and funds are made available, are doing so economically and efficiently and are complying with applicable laws and regulations". [5:1]

The new standards were developed after nearly three years of extensive field work. They were the product of a governmental task force under the GAO's direction that was composed of members drawn from federal agencies, state governments and cities with large grant-in-aid programs. [6] The revised standards applicable to federal, state and local governments, are listed in their entirety in Appendix B. In the author's opinion, however, the key addition was to the set of general standards. The following standard was added to those already in existence:



1. The full scope of an audit of a governmental program, function, activity or organization should encompass:
  - a) An examination of financial transactions, accounts and reports, including an evaluation of compliance with applicable laws and regulations,
  - b) A review of efficiency and economy in the use of resources, and
  - c) A review to determine whether desired results were effectively achieved. [5:6]

Thus, governmental internal auditing became, in theory, a powerful management tool that would be able to achieve the broad ranging appraisals described in the following definition of modern internal auditing:

"An independent appraisal of the diverse operations and controls within an organization to determine whether applicable policies and procedures are followed, established standards are met, resources are used efficiently and economically and the organization's objectives are being achieved". [7:6]

## B. RESEARCH DIRECTION

Even with this new emphasis applied to all levels of governmental audit activity, it is difficult to ascertain if the function of internal auditing and the role of the auditor have been strengthened by the expanded standards. Soon after the GAO published their expanded scope standards, the AICPA, in their 1973 pamphlet entitled "Audits of State and Local Governmental Units", indicated that they did not accept the extended view of auditing that the GAO presented. They stated:

"No auditor is expected to give an opinion on how efficient or economical an organization is or whether program results have been effectively achieved. In such cases, the auditor reports what he finds factually and makes a recommendation for improvements he deems appropriate". [8:639]

Further, recent GAO reports indicate the existence of widespread and serious deficiencies in the internal controls of public sector financially oriented transactions and the



actual creation and maintenance of effective and viable control systems. [9] The additional standard, and its inherent use of operational auditing techniques, projects a fine image for the new breed of governmental auditor; yet, the literature indicates that audits of efficiency and economy have not been widely applied at the state and local levels and examples of successful program effectiveness audits are rare. [10:iii]

In the State of California, for example, the system of auditors at the state, county and municipal levels of government perform various types of auditing duties. At the state level, the office of the Auditor General was established in 1956 as the non-partisan internal auditing and investigative arm of the legislature. Noting a rapid growth of auditing activity in various state agencies, the California legislature recognized the need for special audits of its revenues, expenditures, accounting and fiscal reporting systems. [11]

Counties and municipalities in California receive a large percentage of their revenues from other levels of government, i.e., pass through grant-in-aid and revenue sharing funds for programs such as welfare and public assistance. [12] The nature of auditing at this level of government, therefore, leans toward the strict assessment of financial statements required for reporting and compliance with recently promulgated revenue sharing regulations. The recipient governments are, however, encouraged to audit in accordance with the GAO standards and are, thus, responsible not only for determining the fidelity and legality of the manner in which public funds have been used, but also for making special audits and investigations, including performance or operational audits, of any agency requested by the local legislature. [13:391]





To ensure that these legislative requirements are fulfilled, the expanded standards for auditing developed by the GAO have been adopted at all levels of California government. However, forces exist that are drawing time away from the efficiency, economy and effectiveness audits specified in the standards. For example, the federal government, through the Office of Management and Budget (OMB Circular A-102 entitled "Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments") mandated expanded audit efforts that require annual, rather than the normal tri-annual, comprehensive financial and compliance audits on all state and local governmental organizations that receive federal revenue sharing and grant-in-aid funds. [14:60958] Additionally, the Standard and Poors Corporation, a bond rating service to both the private and public sectors, announced that it would no longer rate or would reduce the rating on obligations of state and municipal governments which did not publish annual financial statements and have those statements audited within six months of the close of the fiscal year. [15] These important initiatives are sufficient inducements to insure compliance with the tenets of financial auditing, but the extra workload may do little to advance the need for internal auditing's other functions and may lead to the avoidance of operational audits at these levels of government.

Given the increasing need for efficient resource management, the function of the internal auditor in the areas of efficiency, economy and effectiveness will become increasingly vital to county officials and mayors in the proper execution of their responsibilities as accountable resource managers. The task of this thesis, therefore, is to determine if the auditing agencies at the county and municipal levels of government within the State of





California have been able to meet the challenges of the expanded scope audit.

### C. OBJECTIVE

The purpose of this thesis is to analyze the extent to which the concepts and techniques of the GAO expanded scope audit standards are currently utilized within the county and municipal levels of government in the State of California. The specific objectives, therefore, are:

1. To determine the degree of compliance with the expanded scope audit standards issued by the GAO in 1972, and revised in 1981;
2. To determine the underlying causes of non-compliance; and,
3. To make recommendations designed to improve the effectiveness of local level governmental internal auditing.

### D. METHODOLOGY

To supplement a library search for background material on state and local level governmental auditing's theoretical scope and procedures, the Auditor General of the State of California and other county and municipal auditors provided reports summarizing the operations and policies of their offices. In order to gather other pertinent data, a questionnaire was distributed designed to elicit the required information in the key areas concerning the operation of County and Municipal Audit offices. These major topical areas were Organization and Independence, Professional Skills, Audit Performance and Reporting Practices. The general thrust of the questions associated with each key area will be delineated later in the thesis.



## E. THESIS ORGANIZATION

This thesis is divided into six chapters. Chapter I is introductory in nature and provides the reader an overview of the subject area and the rationale for the thesis.

Chapter II presents a brief historical discussion of the growth and development of auditing in both the private and public sectors as a means of providing the reader with the background information necessary to appreciate the scope of current governmental internal auditing.

Chapter III provides a discussion of each type of audit specified in the GAO standards as well as an examination of required qualifications, independence, planning, supervision, legal and regulatory requirements, internal control, evidence and reporting procedures.

Chapter IV discusses the specific methodology employed in determining the current status of internal auditing at the county and municipal levels of government in the State of California. This includes an indepth review of the sampling technique utilized as well as the purpose and intent of each question asked in the author designed questionnaire. Specific problems pertaining to the data gathering function are also discussed in detail.

Chapter V arrays the data provided by returned questionnaires. The answers submitted by the respondents are presented, discussed, compared and analyzed. Problems evident in the use and expansion capability of internal auditing at the local government level are also identified.

Chapter VI provides a summarization and attempts to make recommendations pertinent to the thesis objective. Specific conclusions are made and issues for further investigation have been identified.



## II. BACKGROUND AND PERSPECTIVE

### **A. PREFACE**

In order to accomplish the objectives of this thesis, it is necessary to provide the reader with definitive background material in the following key areas:

1. The history and development of internal auditing; and,
2. The emergence and development of internal auditing in local level government.

A thorough understanding of these points will serve to provide the reader with an appreciation for internal auditing in general, and the perspective necessary to knowledgeably consider a discussion of the various critical aspects of effective internal audit organizations that follows in subsequent chapters. Accordingly, the purpose of this chapter is to clarify, through the use of narrative descriptions and comparisons, the role of internal auditing and its intrinsic relationship to government.

### **B. THE DEVELOPMENT OF INTERNAL AUDITING**

#### **1. General**

Auditing can trace its lineage back in time to the third millenium B.C., where archaeologists have unearthed evidence of the preparation of summary lists of transactions by Mesopotamian scribes. The evidence shows tiny dots, ticks and circles near the figures, leading one to believe that this was the beginning of control systems designed to provide a division of duties and a systematic checking of records. [16] Other early civilizations were also concerned





with their fiscal activities and those of their officials. The Egyptians, Persians and Hebrews required the audit of official records by another, independent source and, during the reign of the Roman Empire, auditing techniques were used to prevent the fraudulent acts of questors. [17]

During the Middle Ages, auditing continued its earlier established pattern of being concerned primarily with the honesty of individuals charged with fiscal, rather than managerial, responsibilities. Basically, receipts were tested against public knowledge of what should have been collected; disbursements were made public in the hope of reducing improper expenditures. Managers of private enterprises during this time were routinely subject to audit. Arthur H. Adelberg cites the following example:

"The book of ordinance in 1564 of the Worshipful Company of Pewters, a craft guild, provided that four auditors were to be chosen from the general membership each year to examine the book of account and verify that they were correct. Their ordinance of 1581 even gave the four auditors the authority to impose fines on the guild's officials for any irregularities or improprieties discovered." [17:36]

Beginning in the early 1600's, as the feudal period began to degenerate, the normally agrarian European society began giving way to more business oriented activities. A.C. Littleton comments on this period in auditing's history in the following statement:

"With the advent of business, there came, instead of accountability, the accounting of problems attendant upon the ownership of property and the calculation of profits and losses. Auditing shifted from checking on an individual's stewardship to scrutinizing written records and the testing of entries by documentary evidence." [18:264]

Other literature concerning this area indicates that the legal profession was primarily responsible for the emergence of auditing during this period. As executors of estates and trustees in bankruptcy proceedings, they often faced complex fiscal situations that they were not equipped to handle.





Thus, they employed auditors to perform the detailed check of the requisite accounting records with the objective of discovering the existence of fraud. [17] It may be that these semi-professional auditors were the link connecting this period to the present day internal auditor.

The 19th century witnessed a metamorphosis in the use of auditing that would not have been possible without two major developments in Great Britain. The Bankruptcy Statutes, concerned with the financial administration of a bankrupt entity's affairs for the protection of creditors, and the British Companies Act, allowing stockholders to engage auditors to perform a complete investigation of a company's accounting records, extended the services rendered by accountants from manual record keeping to "professional" auditing. [17:37] Wealthy Englishmen, who invested large sums of money in American corporations sent their British auditors to periodically check on their invested capital. These European auditors, working beside less experienced local accountants, provided America with the needed exposure and insight into the nature and responsibilities of auditing.

Beginning in the early 1900's, the practice of publishing annual reports to the shareholders of publicly held corporations was made commonplace. Since the United States had no statutory requirements in force at the time, the dissemination of audited financial data grew on a strictly voluntary basis. [17] In the author's opinion, this practice was most probably prompted by the belief that ownership of corporate securities was a particularly desirable source of investment capital and that the distribution of audited financial statements would further encourage and stimulate such investment. However, the fledgling occupation was the object of severe external



criticism during the first quarter of the 20th century because of the lack of consistently applied principles and the deliberate certification of misleading financial statements. Concerning this period in auditing's history, John I. Carey stated:

"Without authoratative guidelines, without control over the qualifications of its members, and without disciplinary authority there is little that can be done about the quality of independent auditing." [19:62]

Yet, it would be many more years before this group could claim professional status and enforce meaningful standards of ethical conduct.

Internal auditing in its modern context, received a great push forward when Congress enacted the Securities Act of 1933 and the amended Securities and Exchange Act of 1934. The intent of these initiatives was to put the issuance of publicly traded securities under regulation and to use accounting and auditing as statutory instruments in accomplishing their goal. Corporate management was, thus, made responsible for the accuracy of the financial statements they filed with the United States Securities and Exchange Commission (SEC). This requirement led corporations away from total reliance upon their external accountants, who often could not provide them with the indepth analyses required for proper reporting purposes. They hired internal accountants and auditors, who became intimately familiar with the organization and its long term strategies, to verify accounting records and to assure compliance with accepted accounting controls.

It was not until 1941, coincident with the formation of the Institute of Internal Auditors (IIA), that professional status and recognition as a separate discipline was given to the field of internal auditing. [7] It was at this point that auditing "began to range beyond the books of



account and began to assume a new posture". [16:25] Victor Z. Brink, a charter member of the IIA, recalled the formative pressures and early history of internal auditing as a profession as follows:

"In 1941, there were quite a few Internal Auditing departments but the number was very small in relation to the number of organizations that needed such services. There was, at that time, however, an increasing awareness of the growing size and complexity of all kinds of operations by business, government and other types of organizations.

"There was an increasingly common recognition that Internal Auditing departments could make a more important contribution to help management cope with the emerging complexities.

"1941 was the year when a small group of forward looking internal auditors became discontented with the visibility provided by existing professional associations and decided that a new professional organization should be established and dedicated exclusively to the interests of internal auditors.

"During the years following 1941, and especially after World War II, a number of interrelated forces were at work....continuing expansion of the size and complexity of business corporation, governmental bodies and philanthropic organizations. Business corporations were also becoming increasingly diversified and extended geographically to include more international operations.

"The result was additional concern on the part of management and a related effort to expand and upgrade internal auditing groups. Management also became increasingly aware of getting more benefits from the substantial amounts of money expended to maintain internal auditors and, therefore, was motivated to use them to help solve broader operational problems.

"At the same time, internal auditors became increasingly aware of their opportunities to go beyond the narrower protective role and to make more substantial and dynamic contributions to management's welfare. This new emphasis of internal auditors expanding their traditional financial auditing role came to be known as operational auditing." [20:25-26]

Thus, since 1941, the profession of internal auditing has grown, matured and prospered, while ever expanding its role to serve a wider range of organizational and operational needs.

To illustrate this growth and development within the profession, a current description of the function and objective of internal auditing with respect to operating





management, as outlined in the IIA's latest statement of Responsibilities of Internal Auditors, follows:

"The objective of internal auditing is to assist all members of management in the effective discharge of their responsibilities by furnishing them with analyses, appraisals, recommendations and pertinent comments concerning the activities reviewed. Internal Auditors are concerned with any phase of business activity in which they may be of service to management. This involves going beyond the accounting and financial records to obtain a full understanding of the operations under review. The attainment of this overall objective involves such activities as:

1. Reviewing and appraising the soundness, adequacy and application of accounting, financial and other operating controls, and promoting effective control at reasonable cost,
  2. Ascertaining the extent of compliance with established policies, plans and procedures,
  3. Ascertaining the extent to which company assets are accounted for and safeguarded from losses of all kinds,
  4. Ascertaining the reliability of management data developed within the organization,
  5. Appraising the quality of performance in carrying out assigned responsibilities, and
  6. Recommending operating improvements."
- [ 20:27 ]

This chapter has, thus far, traced the need for and the development of internal auditing from ancient times to the present. It has been shown that the need for independent verification and appraisals of financial transactions dates from the earliest recorded business activity and it appears that the need for organized auditing services grew in direct relation to an increase in complexity and scope of business operations. Thus, the development of private sector internal auditing closely parallels the expansion of business enterprises into more complex endeavors and geographically separated locations. However, the public sector was not exempt; it may be postulated that forces similar to those that drove industry to accept internal auditing drove the





public sector to impress internal auditing on all levels of its organization. Therefore, this chapter will continue with the objective of providing background material into the emergence and purpose of internal auditing in the public sector, with special emphasis on the development of local level governmental auditing.

## 2. Public Sector

Literature in this area indicates that the demand for accounting and auditing services in the public sector related directly to the phenomenal growth in the size and complexity of federal, state and local government. In the beginning of United States history, authoritative writings indicate that the relationship between and the sources of operating funds for all levels of government were clearly defined. In recent years, however, this clear separation has undergone a profound change due to pressures that have created an increasing demand for more and better public services. Today, there are nearly 80 thousand units of government in the United States ranging from a centralized national government to thousands of small, specialized local units. [2] Each of them has legally prescribed jurisdiction, powers and revenue sources, yet none of them are islands in the sea of government. The financial affairs of each unit rests upon a structure of interlocking relationships for the conduct of programs designed to improve the overall quality of American life.[5]

Public sector auditing, although more readily identifiable as a recent phenomenon, does have its roots in antiquity. For example, the Romans were concerned with the fiscal activities of their government officials and utilized auditing procedures to assure that their accountability and their financial transactions were in accordance with popular



desires. The Middle Ages also produced governmental auditors charged with ensuring the correctness of footings and the reasonableness of expenditures and receipts. As an example, the records of the Chamberlains of the City of London were first audited in 1298 by a committee composed of appointed and elected government officials like the mayor, aldermen and sheriffs. By 1310, the committee consisted of six men of the city, elected in the presence of the whole community. [ 17 ]

The early history of the United States provides an interesting example of the need for effective auditing and also of a frequently voiced ploy used to frustrate auditors: "itemize the small expenses to death, and lump all the big ones together." The example that follows is paraphrased for brevity and contains direct quotations as indicated from an article entitled "200 Years of Financial Management" by Allen Schick. [21] Mr. Schick states that "war has been one of the driving forces in the upward path of federal spending." He continues by offering an example of the need for effective scrutiny of public spending: "It all began with a General. General George Washington was not only first in war and first in peace, but also first in American budgeting." When offered a tax free annual salary of \$6000, Washington, "the dedicated public servant that he was", replied, "far be it from me to accept payment in the service of my country; just pay my expenses."

When Washington submitted his expense vouchers for payment, they included such items as "a gilded coach for Martha, imported wines, servants and a host of similar items." As to the accounting record of these necessary expenses, Mr. Schick shows the following examples: "oats for mule - three and one-half cents", and on the next page, "Sundry and Miscellaneous Expenses - \$3500." One cannot



speculate whether an effective Continental Congress audit unit would have precluded the disbursement of public funds for expenses couched in such vague terms. However, one can assert that an audit of the General's accounts would have discovered the questionable items, alerted the authorizing body and allowed timely and appropriate action to be taken.

In the twentieth century, the definitive authority on governmental auditing at all levels is the GAO. GAO, created by the Budget and Accounting Act of 1921 as the national public auditing agency, is a non-political, non-partisan agency of the legislative branch of government acting on behalf of Congress. It is charged with examining the manner in which government agencies utilize appropriated public funds, and over the years has evolved to be further charged with making recommendations on the economy and efficiency of public expenditures. [22:1] Today, GAO defines auditing as follows:

"The term audit is used to describe not only work done by accountants in examining financial reports but also work done in reviewing (a) compliance with applicable laws and regulations, (b) efficiency and economy of operations and (c) effectiveness in achieving program results."  
[5:3]

Thus, GAO is not limited to examining the financial statements, but may investigate all matters relating to the receipt, disbursement and application of public funds and may recommend measures that lead to greater economy, efficiency and effectiveness in the expenditure of public funds.

The federal government has grown since the creation of the GAO, and as its power and function expanded, more of the burdens of governing were passed to the states and their subdivisions. Literature indicates that the flow of billions of dollars from Washington, D.C. to state and local governments in the form of grants-in-aid and revenue sharing





funds called for the creation of an extensive management system designed to handle the subsequent rise in expenditures and reporting requirements. However, this represents only one factor that influenced the emergence and professional development of internal auditing at the state and local level. Martin Ives, CIA, lists other major factors that affected the scope of audits in local level government as follows:

1. The rapid growth of government expenditures, the failure of the tax base to produce revenues sufficient to keep pace with the growing expenditures and the resulting increase in the tax rates;
2. The general impact of inflation on governmental expenditures and the inability of government to offset the increased costs with increased gains in productivity; and,
3. The high level of public frustration caused in part by the apparent failure of government to produce results equivalent to the increased expenditures and higher tax rates. [23:50]

The course of governmental internal auditing has been influenced by these economic, social and political factors. This statement is evidenced by the following quotation made by Elmer B. Staats, former Comptroller General of the United States:

"Today government at all levels is beset with financial problems; one need only read the papers. Our larger cities have serious financial problems. The federal government and state governments, too, are feeling the pinch of steadily rising costs accompanied by widespread taxpayer opposition to tax increases. In such a situation, the skills of the internal auditor are often just what is needed." [24:61]

To meet these new expectations and needs, the internal auditors' scope of audit must flow from the needs of management. They must gather timely, relevant and accurate information on performance to assure accountability, the proper operation of government programs and the accomplishment of governments' expanding objectives with constant, or even decreasing, resource availability.





The decade of the 1960's was especially difficult for all levels of government in the United States as rising personal expectations, fueled in a large part by political promises, gave way to disillusionment and frustration. [23] Many Americans blamed government; the taxpayer sensed that government was spending too much and was accomplishing too little. The problems in the states and cities during this period tended to heighten the need for increased public accountability. When government expenditures were a small portion of the gross national product, public accountability was defined with such intrinsically individual terms as "honor and faithfulness". However, as government's bite increased, and the need for increased productivity became evident, accountability was broadened to include the economy and efficiency of planned expenditures. [17]

In 1976, a joint committee of representatives from the Municipal Finance Officers Association, the IIA and Price Waterhouse and Company conducted a study into the role of the auditor in local level government. Basically, their research revealed that the internal audit function should perform the following services for local government:

1. Check application of administrative policies and directives;
2. Evaluate the effectiveness of administrative control;
3. Confirm the existence of assets with a view toward preventing or discovering fraud;
4. Check the authenticity, completeness and fairness of accounting and financial data;
5. Assess the effectiveness and efficiency of operations and activities;
6. Check compliance with federal and state grant programs;
7. Provide a training ground for management oriented personnel; and,
8. Handle certain non-recurring problems that require an investigative approach. [28:60]



In the author's opinion, the value of auditing is in its ability to independently appraise the operation of government. As more politicians become aware of the benefits of internal auditing, more emphasis will be placed on its acceptance at the local level. Internal auditing can help local level governments and the public officials who serve their constituencies reduce costs, improve efficiency, eliminate unproductive programs and aid in the process of accountability.

The role of the auditor with respect to public accountability extends back to the ancient Greeks. According to Aristotle: "some officials handle large sums of public money; it is therefore necessary to have other officials to receive and examine the accounts." [23:52] The responsibility of today's government auditor is similar to that described by Aristotle. They are expected to examine the accounts, but the term "accounts" encompasses far more than the financial accounts, it now embraces the administrator's total accounting for efficient and effective performance.

What has occurred in the area of governmental internal auditing closely parallels the evolution of private sector auditing in time, concept and achievement. Some of the factors listed earlier are similar to those that influenced the private sector to develop internal auditing organizations and have produced a similar concern for operating efficiency and cost reduction. The other factors, more peculiar to the public sector, have caused governmental auditing to move more deeply into the program effectiveness direction. In this regard, the IIA redefined the scope of private sector internal auditing in their 1971 Statement of Audit Responsibilities; similarly, the GAO redefined and expanded the scope of public sector auditing in 1972. The



resulting broadened outlook has had an effect on the financial accountability aspects of auditing.[23]

### C. SUMMARY

This chapter has briefly discussed the history of private and public sector auditing and sought to provide the reader with the reasons for the emergence of auditing in local level governments. It has been shown that the need for public sector auditing grew from the need to provide government managers and officials with better information on their performance. Government expansion taxed the capabilities of these managers, and thus, more reliance was placed on the advisory and investigative capacities of internal auditors. It may be postulated at this point that since the complexity and scope of governmental operations will not diminish in the foreseeable future, management of governmental programs will increase their reliance on internal auditing as an aid to efficient operations. Accordingly, the following chapter will continue with the objective of providing the reader an insight into the meaning and significance of the expanded scope audit standards issued by the GAO in 1972.





### III. GAO'S AUDIT STANDARDS

#### A. PREFACE

This chapter will seek to define what internal auditing should be designed to accomplish in order to provide a standard of measurement from which to judge the current effectiveness of internal auditing within County and Municipal governments in the State of California. Beginning with a thorough discussion of the levels of audit specified in the General Accounting Office (GAO) Standards for Audit, this chapter will continue with an indepth discussion of the meaning and significance of the expanded scope standards issued by GAO in 1972.

#### B. GENERAL

Fundamental to a democratic society is the requirement for governmental agencies utilizing public funds to periodically render a full accounting of its activities. [5] This accountability is inherent in the process of government. The following quotation from Ellsworth H. Morse, Jr. points toward this concept and the integral part to be played by governmental auditors:

"Internal auditing can be an important tool in promoting efficient and judicious use of the more than \$200 billion taxpayers provide the U.S. Government to finance a wide range of activities, services and facilities.

"There is no place in government for the misuse or the ineffective use of public money because money is a scarce resource in relation to all the demands for public services and activities that are placed upon governments.

"Governmental management systems need good mechanisms to help promote efficiency, economy and effectiveness in the use of public funds. They need them perhaps more than private industrial systems where the external discipline of the market place is a strong factor in encouraging such results." [ 25:10 ]





Thus, in preparing their new audit standards for publication, the GAO included the concepts of fiscal, managerial and program accountability. As discussed earlier, the standards provide an audit scope that goes beyond financial and compliance auditing to encompass audits of efficiency and economy and the achievement of programmed results. However, the following basic premises also underlie the audit standards and were considered in their development:

1. Public office carries with it the responsibility to apply resources in an efficient, economical and effective manner to achieve the purposes for which the resources were furnished;
2. A public official is accountable to those who provide the resources he uses to carry out governmental programs. Consequently, he should be providing appropriate reports to those to whom he is accountable;
3. Auditing is an important part of the accountability process since it provides independent judgements of the credibility of public officials' statements about the manner in which they have carried out their responsibilities. Auditing also can help decision makers improve governmental operations by identifying where improvements are needed;
4. The interests of individual governments in many financially assisted programs often cannot be isolated because the resources applied have been comingled. Therefore, an audit should be designed to satisfy both the common and discrete accountability interests of each contributing government;
5. Cooperation by federal, state and local governments in auditing programs of common interest with a minimum of duplication is of mutual benefit to all concerned and is a practical method of auditing intergovernmental operations; and
6. Auditors may rely upon the work of auditors at other levels of government if they satisfy themselves as to the other auditors' capabilities by appropriate tests of their work or by other acceptable methods. [5:3-4]

In order to provide the community of governmental auditors a practical approach to the audit of governmental units, the Comptroller General of the United States issued a publication in 1972 entitled "Standards for Audit of Governmental Organizations, Programs, Activities and



Functions". The procedures contained therein incorporated the accepted basic premises and were applicable to federal, state and local governmental auditors. The objective of the standards was threefold:

1. To provide a means by which federal, state and local level governments could improve the quality of their auditing function;
2. To improve the overall control of government organizations; and
3. To facilitate the evaluation of government entities.  
[10:3]

These standards conformed to the generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA), however, they included the much broader definition of auditing considered imperative for the growth and development of governmental auditing.

#### C. LEVELS OF AUDIT

The GAO standards define the elements of a governmental audit as follows:

"Level I - Financial and Compliance. Determines (a) whether financial operations are properly conducted, (b) whether the financial reports of an audited entity are presented fairly, and (c) whether the entity has complied with applicable laws and regulations.

"Level II - Economy and Efficiency. Determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies of management information systems, administrative procedures or organization structure.

"Level III - Program Results. Determines whether the desired results or benefits are being achieved, whether the objectives established by the legislature or other authorizing body are being met, and whether the agency has considered alternatives which might yield desired results at a lower cost." [5:2]

In its publication, the GAO explicitly states that an audit need not have all three elements to qualify as a complete and thus full scope audit; and, indeed, it is often not



desireable or practical to accomplish the full scope audit as defined. Constraints of time, money, actual organizational or managerial need, or legal requirements must be taken into account prior to the determination of audit scope and direction. Nevertheless, these elements highlight the importance of the auditor having a clear understanding of what is entailed in each level of audit.

## 1. Financial and Compliance

In conducting a Level I audit, the auditor's focus is on the financial statements prepared by the organization for external users. The fiscal operations and record keeping procedures are scrutinized by the auditor for correctness, consistency and completeness. The purpose of this audit is to determine whether the entity's financial statements fairly present its actual financial position and results of operations. Further, the auditor is interested in the integrity of the system of internal control and the adequacy of the accounting system to record transactions and accurately report the results of operations.

This indepth financial examination is also conducted to assure that the entity has conformed with generally accepted accounting principles and that all records and statements are in compliance with existing and applicable statutes, regulations and governing body determinations. Although being akin to the traditional government audit, this audit is also concerned with the practicality and reasonableness of the entity's policies, laws and rules, as well as their effect of operations.

The auditor's function is to gather sufficient, reliable and irrefutable evidence that will allow him or her to render an opinion as to the overall clarity of the organization's financial reports. Prior to publishing an





unqualified report, the auditor must insure that transactions are recorded accurately and that they are complete and summarized in a consistent manner.

## 2. Economy and Efficiency

In conducting a Level II audit, the auditor's focus is on the way organizations use available and allocated resources. Specifically, its purpose is to identify methods of improving operations and reducing cost. According to a GAO pamphlet entitled "Answers to Frequently Asked Questions," audits of economy and efficiency delve into matters such as the following:

1. The need for goods or services provided or procured;
2. The reasonableness of costs incurred or expenditures made;
3. The adequacy of safeguards over and care of resources acquired;
4. The proper utilization of resources; and,
5. The adequacy of revenue received for goods or services sold. [30:13]

It goes on to state that:

"Such matters are pursued primarily from the standpoint of improvements needed - usually by identifying avoidable costs or waste, possibilities for increased revenues and alternative procedures for producing similar results at lower costs or better results at the same or lower costs." [30:13]

Thus, the auditor is concerned with the organization's success in carrying out its responsibilities and whether it has done so with due regard to the conservation of public funds.

An approach utilized to conduct an audit concerned with efficiency and economy is the use of a technique called operational controls review. This review, as it applies to a public sector organization, has six steps:

1. Obtaining a working knowledge of the entity's purpose, systems and operations;





2. Identifying areas where efficiency and economy might be improved;
3. Evaluating management practices in comparison to preferred practices;
4. Assessing the impact of departures from preferred practices;
5. Formulating possible improvements and cost reductions; and
6. Communicating the findings and possible recommendations to management. [10:18]

Thus, a prerequisite to a Level II audit is a demand that the auditor be familiar with the organization's overall operational strategy. He or she must have firm, first hand knowledge of the pulse points within the entity in order to investigate whether it is getting the most it can for the money and resources it consumes. Therefore, it is not sufficient for the auditor to determine if a particular good was ordered, received, billed and paid properly; the auditor must be concerned with whether the good was required, was used productively and whether it could have been procured at a lower price.

### 3. Program Results

In conducting a Level III audit, the auditor's focus is multi-faceted. The auditor is concerned with how successful the program is in accomplishing its intended results. However, he or she is also concerned with whether it is staying within its financially appropriated boundaries, its costs are commensurate with its benefits and whether sufficient alternative programs have been examined for their potential. Anthony and Herzlinger describe the process of program results auditing in the following manner:

"We are here concerned not with evaluations of specific aspects of a program, but rather with the broad evaluation of a program as a whole, particularly of those programs whose continued existence is optional. If these programs are not effective, they should be discontinued or at least redirected." [26:521]



It is apparent, that the auditor's function is to report meaningful observations and to make constructive recommendations as required to assure the continued effectiveness of governmental programs.

The role of the auditor in this regard is to assist management by providing useful information as to whether a program has adequate, attainable goals and if these goals are being achieved. Merely the identification of these programs can produce substantial savings by providing legislators with the evidence necessary to distinguish between programs that work and the programs which do not. Again, Anthony and Herzlinger provide an insight into this phase of program results auditing:

"...legislation requiring oversight of programs has been in effect since 1946. The scope of formal evaluation efforts was greatly enlarged in the early 1970's when the federal government delegated to the states the task of providing most social services and required as a condition of funding these programs that a formal means of evaluating them be established. At about the same time, there was widespread interest in sunset legislation - laws that provided for the automatic discontinuance of a program unless it was evaluated every six to eight years and found to be effective." [26:521]

In order to determine if a program is effective, the programs' output must be measured against a clearly defined standard. The auditor must view the organization from the standpoint of whether its goals and objectives are being achieved through the program's performance. Inadequately defined, or non-existent goals and objectives can cause confusion in the attempt to ascertain a particular program's effectiveness. For this reason, in order to perform meaningful audits, established standards of measurement and operational goals and objectives must be identified or agreed upon from the outset.



#### D. RELATIONSHIP TO OPERATIONAL AUDITING

The term "operational auditing" refers to the practice of examining and evaluating the operating, managerial or administrative performance of an activity beyond the requirements of a financial accounts or statements audit. Its primary purpose is to identify opportunities for greater efficiency and economy and to improve the effectiveness of carrying out procedures and operations. Thus, its objective of providing better decision making information for managers and bringing about improvements within the entity, closely parallels the objectives of the three types of audit defined in the previous section of this Chapter.

In order to show this relationship more fully, the following description of operational auditing is provided:

"Operational auditing appraises the administrative controls within activities other than those included in accounting and financial audits. For example, some of the activities regularly covered by operational audits are purchasing, receiving, shipping, stores, personnel, office services, production control, engineering, quality control, insurance, advertising and marketing.

"The internal auditor's objectives are based on the needs of the management he serves. These needs may be summarized as follows:

"Top management needs:

1. assurance that its plans are comprehensive, consistent and understood at the operating level;
2. objective information on how well its plans and policies are being carried out the the operating level; and
3. reassurance that all operating reports can be relied upon as a basis for action.

"Operating management needs:

1. information on weaknesses in administrative controls particularly as to possible aources of waste; and
2. aid in measuring the efficiency of operations by feedback or information on the quality and cost of the work and adherence to schedule.

"In attempting to meet these managerial needs, the internal auditor samples the work performed to see whether it is in accordance with approved





procedures. He verifies the accuracy and consistency of the information contained in the operating reports and he studies the format of these reports to determine whether the information is provided in a meaningful form. "Above all, the internal auditor is alert for indication of sources of waste and opportunities for improvement. The auditor's traditional protective responsibility for seeing that the company's needs are safeguarded against loss, has now become more broadly interpreted as a constructive responsibility for providing protection against waste of any kind, and in general to help management operate effectively and profitably." [27:832-833]

Thus, this type of auditing encompasses the elements of economy and efficiency and program results as described in the GAO standards; the deviations relate to specific refinements caused by a strict public sector orientation.

Up to this point, the thesis has discussed the types of auditing mandated by the GAO to be performed at all levels of government and their inescapable relationship to operational auditing techniques. The reader has been provided with a brief description of each audit level and the auditor's specific role and function within each level has been delineated. The guidelines utilized to conduct these audits, however, are discussed in the following sections.

## E. THE GENERAL STANDARDS

### 1. Scope of Audit Work

This first standard demands of the auditor an audit broad enough to fulfill the needs of all possible and potential users of its results. The objectives of the full scope audit described within this standard are as follows:

1. The examination of the total financial operations of the entity shall include sufficient audit work to determine whether the audited entity is:
  - a) maintaining effective control over revenues, expenditures, assets and liabilities;
  - b) properly accounting for its resources;



- c) preparing financial reports that are accurate, reliable, useful and fairly presented; and
  - d) complying with applicable laws and regulations.
2. The review of efficiency and economy shall include an indepth investigation into whether the entity is carrying out its responsibilities, and
  3. The review of program results shall include an indepth inquiry into the results or benefits achieved and whether the programs reviewed are meeting their established objectives." [5:12]

Since the terms efficiency and economy are both relative, the GAO does not intend that auditors render an opinion as to whether an organization has reached an acceptable level of either. Instead, the auditor is concerned with the identification of uneconomical and inefficient practices such as duplication of effort, overstaffing and the wasteful use of resources, as well as how these practices can be eliminated.

Program results audits are also concerned with gathering accurate and reliable data relevant to the program or activity being reviewed. This data must be evaluated against a prescribed norm, and, since wide variations in individual opinions are possible, the GAO recommends that the audit work in this area be centrally coordinated and verified by the Chief Auditor or an independent group of his staff. [5]

## 2. Qualifications

The second general standard places a responsibility on the auditor for ensuring that the audit is conducted by an individual or group possessing the collective knowledge required to perform the review. High quality personnel, those having skills commensurate with the general level of audits undertaken, will ensure that the audit will be adequately performed and that the findings and recommendations of the group will be accepted for action by



management. The general requirements for staffs performing governmental audits are:

1. A basic knowledge of auditing theory and procedures and the education, ability or experience to apply this knowledge to audit work;
2. A basic knowledge of governmental operations and organization; and
3. The possession of the skills required for the audit; i.e., to audit financial statements, the auditor should be proficient in accounting. For other types of audit work, the auditor may need acceptable skills in statistics, law, engineering or actuarial science.  
[5:13]

Because of the variations in program objectives and organizational structures, as well as differences in statutes, laws and regulations, these skills apply to the audit unit as a whole. If these skills are required, but are not possessed by the assigned audit unit, a cooperative effort with different audit organizations is prescribed.

### 3. Independence

The third general standard requires that the auditor or audit unit be sufficiently independent to produce unbiased opinions, conclusions and judgements. In examining the extent of his or her independence, the auditor must consider attitudes and beliefs in relation to three classes of impairments; personal, external and organizational.

Personal Impairments are circumstances which cause the auditor to be in any way partial because of his personal situation. These circumstances include personal relationships with the auditee, preconceived ideas about the objectives or quality of operation of a particular program, previous involvement in a decision making or managerial role within the activity to be audited, any political or social biases and prejudices or a financial interest in the organization.





External Impairments are factors that restrict the auditors ability to render objective opinions or conclusions. These factors may include interference that modifies the scope of the audit or activities and functions within the organization to be audited, denial of access to source documents, retaliatory restrictions placed on the funds of the audit group or influences that place the auditor's employment in jeopardy.

Organizational Impairments are those restrictions that affect the audit because of the units place within the organizational structure of government. That is, since auditors may be subject to policy direction by superiors who are indirectly involved in the governmental process, the unit should be isolated as much as practicable from the line management function. These auditors should be removed from possible political pressure so their findings can be reported without fear of censure. [5]

#### 4. Due Professional Care

The fourth general standard focuses on the responsibility of the auditor or audit group to employ high professional standards in the conduct of governmental audits. It imposes upon the auditor a requirement to be alert for situations that could indicate fraud, improper expenditure of funds, inefficiency or waste. Exercising due professional care implies the use of good judgement in the selection of test procedures and in the preparation of reports to management. It also implies a mutual understanding of the organization's objectives, a good working knowledge of the organization's operational status and the authoritative interpretation of effective output measurement criteria. [5]





## F. THE EXAMINATION AND EVALUATION STANDARDS

### 1. Planning

This standard places the responsibility for the performance of adequate advanced planning, as a basis for an effective audit, on the auditor or the assigned audit unit. Sufficient planning is essential in the identification of areas to be covered by the audit and to permit the optimal scheduling of work to make the best use of available manpower. Audit plans, however, must remain flexible enough to permit any special examinations and to meet the needs of changing managerial circumstances. The units' planning should include coordination with other audit groups as appropriate, the assignment of qualified personnel to the audit, the limitation of the work to be performed and the identification of the format and content of the reports to be issued. [5]

### 2. Supervision

This standard places the responsibility on the auditor for ensuring that less skilled audit staff members receive appropriate guidance in the performance of their work. Proper supervision requires effective control from the beginning of the audit, training, assignments to audit based on available skill and providing clear instructions as to the assigned tasks. Supervisory reviews should be directed toward the substance and method of the audit to insure the conformance with auditing standards, the proper execution of the audit program and the accomplishment of the audit's objective. It should also ensure that the working papers properly document and support the audit's findings and that it provides a basis for the preparation of a meaningful report. [5]



### 3. Legal and Regulatory Requirements

In the audit of governmental organizations, an understanding of the pertinent laws and regulations that govern an entity's operation is particularly important to the auditor or audit unit. This standard places the responsibility upon the auditor of determining whether the organization has complied with the requirements of existing laws, statutes, policies and regulations. It is imperative that the auditor familiarize himself with those legal and legislative initiatives that apply to the unit under review because the nature of the review will, of necessity, vary depending upon the level of audit being performed.

### 4. Internal Controls

This standard places upon the auditor the responsibility to determine the degree of reliance he or she can place upon the information he is supplied by the organization under review. Internal control is the organizational plans, methods and utilized measures that safeguard assets, verify the accuracy of financial transactions and encourage compliance with managerial policies, procedures and practices.[5] By definition, control begins with delegated authority and planned operations and continues through output and performance reporting. A well designed system of internal control insures efficeincy, economy and the achievement of planned results. Such systems provide current standards against which the entity's output can be measured and allows initiatives that adjust operations based upon conformance to these prescribed standards. Therefore, the auditor needs to concentrate his or her attention on those controls that are integral to the areas being audited and determine if serious deficiencies exist that would impact on the effective operation of the entire system.



## 5. Evidence

This examination and evaluation standard places the responsibility upon the auditor for obtaining sufficient, competent and relevant evidence that will afford a reasonable basis for his opinions, judgements, conclusions and recommendations. [5] The key works in this statement that relate to evidence in general are sufficiency, competency and relevancy. Sufficiency is the presence of enough factual and convincing evidence to lead a prudent man to the same conclusion as the auditor. Although this is judgemental, the judgement of the auditor should be objective. Competent evidence is reliable evidence; it should be the best obtainable. In judging the competency of evidence, the following hierarchy is useful: evidence from independent sources is more reliable than that obtained from the audited activity; evidence developed within a system possessing good internal controls is more reliable than that obtained where weak control is evident; physical evidence gathered by the auditor is more reliable than that obtained indirectly; and, original documents are more reliable than copies. Relevance refers to the relationship of the information to its use; that is, the facts utilized to support a particular audit finding must have a logical relationship to the area under review. [10:205]

The auditor's working papers act as the repository for the evidence accumulated to support the audit's observations and recommendations. Working papers document the audit effort and should be safeguarded and retained for future use. A good set of working papers should be complete and accurate, be clear and understandable, be legible and neat and contain only material directly pertinent to the audit and the related report.





## G. THE REPORTING STANDARDS

### 1. Form and Distribution

This standard requires that an audit report be submitted as a written record of the results of any governmental audit. The audit report is designed to communicate and to persuade; it is the one time that the auditor has the undivided attention of management and, thus, should portray the findings and appraisals of the auditor in such a way as to promote action. Reports should be prepared to disseminate the audit's findings to the widest possible audience, to make the auditor's recommendations clear and less susceptible to misunderstanding and to facilitate and monitor the follow-up and feedback function.

Ideally, the report should be made available to management officials directly responsible for the operations reviewed, to other interested officials who may derive some benefit from the information in the report and, unless restricted by law or regulation, to the general public. However, in cases where classified or other security information is available in the report, this standard provides for a limited distribution only to those directly involved or responsible for the actions of the audited organization. [5]

Top management's role is important in this case because by its inattention or inaction to the findings and recommendations made in the report much of the internal audit unit's constructive benefit can be lost. It is imperative that management recognize their function in this regard and take appropriate action on the written report.



## 2. Timeliness

The value of the audit report is directly related to its timeliness. This standard requires that if a delay in issuing the final report is evident, interim communication by memo or interview should be provided to appropriate officials prior to the final reports publication. This communication is not to be considered as a replacement of the final report, but can alert management to situations that require immediate attention. In this way, it will be possible for management to institute corrective measures prior to the matter impacting on the operation of the entire organization. [5]

## 3. Content

This standard requires that the auditor's final report will be easy to understand, will present the audit's scope and will delineate the auditor's findings and conclusions in an objective manner. All reports will be concise, accurate, complete, fair, objective, adequately supported, constructive in tone and will recognize noteworthy achievements evident throughout the audit. [5]

## 4. Financial Reports

This standard states that the auditor will assume the full responsibility for the financial data presented in a report or will inform the reader through explanatory comments on what degree of responsibility he or she will assume on matters relating to significant financial issues affecting the report or his opinion. Further, each audit report containing financial statements will contain an expression of the auditor's opinion as to the fairness of the data's presentation in relation to the generally accepted accounting principles of consistency and disclosure. [5]



This section has fully described the contents of the expanded scope audit standards published by the GAO. The general standards, the examination and evaluation standards and the reporting standards have been discussed in the detail necessary to fully understand their meaning and significance to governmental auditors.

## **H. SUMMARY**

This chapter has presented a description of each level of audit specified in the GAO Standards for Audit and thoroughly discussed the expanded governmental auditing standards issued by the GAO in 1972. Additionally, this chapter has sought to convey a sense of the actual methodology, techniques and requirements of auditing in order to provide the reader with a perspective on the development of governmental internal auditing. The chapter's objective was to highlight the current function of internal auditing in government and to provide an insight into the sound principles of internal auditing that govern the actions of governmental auditors.

The next chapter will provide the reader with an indepth discussion of the author's research methodology and will deal with the thrust of the questions asked of practitioners to determine their degree of compliance with the GAO Standards for Audit.



## IV. QUESTIONNAIRE DESIGN

### **A. PREFACE**

This chapter presents the research methodology employed by the author to support the thesis objectives discussed in Chapter I. Specifically, an overview is provided of the method utilized to determine the degree of compliance with the General Accounting Office (GAO) Standards for Audit at the County and Municipal levels of government in the State of California. Also presented in this chapter is a discussion of the purpose and intent of each question asked in a questionnaire used to gather data pertinent to the subject area.

The data gathered from the questionnaire will be analyzed in the next chapter. Specific conclusions and recommendations concerning the relevance of the data to the future growth and development of internal auditing in local level government will be detailed in the final chapter.

### **B. THE QUESTIONNAIRE**

This section highlights the questionnaire and focuses on the following interrelated survey and data collection issues: the methodology employed, including the basis for sample selection, and the measures utilized for comparative analysis. Specific aspects of these issues which the author feels are important to the readers understanding of these analytical procedures are described in detail.





## 1. Sampling Technique

A survey was conducted to include County and Municipal Auditors in the State of California. The survey was accomplished by the questionnaire provided as Appendix C. In addition to pertinent background data, the questionnaire was designed to gather data concerning the organization and independence, the professional skills, the audit performance and the reporting practices of the organizations surveyed. The questionnaire was also structured in a manner to permit an assessment of the degree of compliance with the General Accounting Office (GAO) Standards at these levels of government.

The survey questionnaire was mailed to all 58 County Auditors and to an equal number of Municipal Auditors in the State of California. The Municipal Auditors were scientifically chosen from the total population (417) of municipalities within the State. Cities were drawn by a random selection process from the California Roster 1980-81 which is compiled annually by the Secretary of State. All cities listed in the Roster were assigned a sequential number and the municipalities selected to receive a questionnaire were then matched by the random number generator capability of the Texas Instruments TI-59 Programmable Calculator.

Additionally, a survey test was performed prior to the main questionnaire mailing. Six questionnaires were distributed, three to County and three to Municipal Auditors. The respondent's comments concerning the nature of the questions and their ease of understanding were obtained during subsequent personal interviews. Questions that posed possible answering difficulties were changed prior to the questionnaire being mailed to additional practitioners.



Sampling within the finite population of the State of California was considered by the author to be a statistically sound procedure because of the States' diverse constituency and broad based, well organized local government system. Further, the percentages quoted in the next chapter are based upon the compiled results of the replies received from the County and Municipal Auditors surveyed. To insure that the responses could be considered statistically discernible, the author considered a minimum return rate of 40% to be required. This figure will provide sufficient information to ensure the reliability of the data and of the author's inferences and conclusions relating to the thesis objectives.

Table I summarizes the specific characteristics or attributes measured by each question within the questionnaire. The questions have been grouped into the major topical areas discussed in the previous paragraph and further subdivided to include their relation to the Audit Standards presented in Chapter II. The reader should note that some of the questions are dual purpose, that is, they serve to provide information on more than one area. In this regard, Table I should be reviewed and utilized in conjunction with the questionnaire presented in Appendix C.

## 2. Measures Utilized

As mentioned above, the questions are divided into major topical areas within the questionnaire; a brief discussion of each area, and an indepth discussion of each questions' thrust is provided below.

### a. Background Information

The information requested in this area had a two fold purpose: to allow a segregation of the data by specific



TABLE I

## Key to Internal Auditing Questionnaire

A. Background Data

> Population of County/Municipality	1
< Elected or Appointed Status	2
> Length of Term and Total Service of Auditor	3
> Type of Budget utilized by County/Municipality	8

B. Organization and Independence

> Segregation of Duties	4
> Scope of Audit Work	9
> Conflict of Interest	12
> Independence	10, 13, 15, 25
> Specific Organizational Matters	16
> Extent of Unit's Growth	18

C. Professional Skills

> Qualifications of current Auditor and Staff	5, 7
> Established Qualifications Standards for Staff	17
> Extent of Training Available and Utilized	14, 19, 21
> Extent of Consultant Usage	22
> Recognition	23

D. Audit Performance

> Compliance	11
> Utilization of Auditor	20
> Audit Programs	26
> Scheduling and planning	6, 27
> Internal Controls	28
> Impediments to Full Scope Audits	30
> ADP Involvement	32

E. Reporting Practices

> Audit Review Process	29, 31, 33, 34
> Final Report Content	35
> Evidence	36
> Timeliness	37
> Supervision	24, 38
> Degree of Acceptance	39
> Distribution	40
> Special Future Potential	40

groupings and to enable the author to correlate data based upon the extent of auditing services available, the size of the staff and the functions performed by the Auditors themselves. All questions in this section were based upon a nominal scaling measurement technique and, due to the straight forward and objective nature of the questions, the author believes the responses were not biased.





Question number 1 of the County/Municipal Internal Auditing Questionnaire concerned the population of the area served by the surveyed auditing units. The auditor was requested to choose the applicable range of population from a list of five possible alternatives. The intent of this question was simple categorization and the results utilized as a means of relating the size of the community served to the auditing functions provided and required.

Question number 2's purpose was to determine whether the responding auditor was an elected or an appointed official, and, if appointed, by whom the appointment was made. The intent was to ascertain, and to make a judgement concerning, the possibility that an appointed auditor might feel an allegiance to the individual or group making the appointment. In such a case, the auditor's review of specific activities and responsibilities might indicate a degree of bias.

Question number 3 requested the Auditor to fill-in the length, in years, of his or her term in office and the total length of time they have served in this capacity. The purpose of this question was to determine if any specific benefits could accrue to an individual governmental unit based upon an auditor's longevity in office.

Question number 8 requested the respondent to classify the type of budget utilized within his or her County/Municipality. This question was designed to gain information on the number of local governments utilizing a program budget format. Its intent was to relate a specific type of budget to the ease of conducting Level III or program results audits.



## b. Organization and Independence

The placement of the auditing unit within the governmental structure can have an effect on its ability to function properly. Auditing is a staff function, however, its position within the chain-of-command should not preclude direct liason with those in the higher eschelons of local government. Independence is generally considered a matter of ethics, but in truth, the quality of that independence is an important central concept within public sector auditing. [32:33] The information requested in this area concerned the perceived impartiality of the auditor, in fact and in appearance, and the effectiveness of the auditors' clerical and professional procedures. Again, the nominal scaling technique was used to measure the respondents answers and, unless indicated below, it was felt by the author that all responses were not susceptible to bias.

Item number 4 was designed to measure the extent to which related governmental functions were performed by the auditor. The completion of duties that are not normally consistent with the responsibilities of an auditor, and his or her subsequent review of these areas, may constitute an impediment to his or her independence and the appropriate segregation of duties. The actual positions held within government by the County Auditors are a matter of record. The additional duties of the Municipal Auditors, on the other hand, were unknown prior to the survey. The question was asked of both groups to categorize the duties performed by the size of the governmental unit and to judge the ability of the auditor to operate effectively and independently within each position.

Item number 9 is an extremely important question, and requests the responding auditors to identify their workload distribution. They were requested to provide



the approximate percentage of time spent on each of the listed types and levels of audit. The intent of this question was to determine the main thrust of the auditor's effort and the extent of his or her compliance with the GAO general standard concerning the scope of audits. It must be understood at this point that the answers represent merely an approximation; a correct and complete summary of information would not be possible without the auditor performing a lengthy historical analysis of their workload. The extra time required to accomplish this might well have resulted in the auditor not responding to the survey in its entirety. However, the author feels that the approximated results will allow, with a degree of certainty, a correlation to be established between the amount of time spent in each area and the size of the County/Municipality or of its available staff.

Question number 10 specifically measured the degree of independence afforded the office of responding auditors. A brief fill-in answer delineating the title of the auditors' reporting senior was requested to determine the auditors' placement within the governmental chain-of-command. The intent of this question was not only to ascertain the auditors' independence, but also to judge the relative stature of the office within these levels of government.

Question number 12 was developed to gather data on the extent to which Conflict of Interest statements were available and maintained. A yes/no question format was utilized to glean information on the auditor's perception of the need to identify and to remain aware of the possibility that impairments to the conduct of audits exist.

Item number 13 queried the auditor concerning the source of his or her operating funds. If not





specifically appropriated to the auditor's office, a brief fill-in answer delineating the governmental department that allocates funds for his or her use was requested. When the Office of the Auditor does not have specific funds appropriated for a justified schedule of audits, the auditor may be requested to perform extraneous functions for the manager in charge of the funds. However, when management has approved a budget for use by the auditor, it is tacit acknowledgement by management at the executive level that the auditor's primary function is to carry out audits and not to perform line duties. [7:609] The intent of this question was to determine the possible extent of this problem at the County and Municipal levels of government within the State of California.

Question number 15 requested the responding auditors to select the appropriate individual or group that provides access approval to the staff auditor for data not readily available or provided during a scheduled audit. Independence in an audit's scope is a fundamental tenet of the GAO standards, and the results in this area were used to appraise the level of compliance with the standards intent.

Item number 16 presents information on five different, yet related, aspects of organizational behavior evident in the unit's audit office. The auditor was requested to provide a yes/no response to matters pertaining to the availability and, therefore, the degree of internal compliance with accepted clerical and professional procedures. The intent of this question was to augment specific responses in other areas of the questionnaire, i.e., the format of audit programs; and to provide definitive information on the availability of guidance to auditors and/or prospective staff members.





Question number 18 asks the responding auditor to choose, from a given list, the statement that best describes the historical action of his or her budget or budget share. In the author's opinion, a steadily increasing budget share would indicate the importance to the community of the auditing function. However, any other answer could be evaluated as a measure of the perceived negative growth potential for governmental auditing in general or be indicative of the current financial status of many local governments. The purpose of this question was to determine the growth, or stagnation, potential of internal auditing units in local government.

Question number 25 requested the auditor to select the appropriate individual or group that sets audit priorities for their organization. This question may have a public sector bias, in that audit priorities are often the province of the local legislature. Although the responses may reflect this attitude, it will be interesting to note if auditors perceive that they are gaining a voice in the proper selection of audits based upon both organizational needs and requirements.

### c. Professional Skills

Competent and experienced personnel are required in order to accomplish the objectives of the GAO expanded scope audit standards. The Auditor must be knowledgeable and have the proper professional credentials, but his staff must also possess the well rounded backgrounds required for the completion of full scope audits. Questions in this section requested the qualifications, eligibility standards and training requirements of the auditor and his or her staff. All but one of the questions in this area utilized the nominal scaling measurement technique; question number 16



was based upon an abbreviated interval scaling form of measurement. In this type of measurement, specific attributes are ranked in their order of importance with the interval between adjacent points on the scale being equal. Again, because of the straight forward and objective nature of these questions, the author believes that the responses would not be biased.

Question number 5 requested the auditor to check the applicable professional credentials he or she has attained and to fill-in the college or advanced degrees the auditor holds. This questions' purpose was simply to determine the educational and professional credentials held by County and Municipal Auditors in the State of California.

Question number 7 concerned the size and the professional and educational qualifications of the audit staff. Responding auditors were requested to fill-in blanks with the applicable information concerning the total number, the number with college or advanced degrees and the number of CPA's and CIA's on their current staff. The questions' purpose was to determine the size and capabilities of the entire staff and to link these results to the capacity for completing the scheduled audits.

Questions numbered 14 and 19 were developed to determine if a formal training program exists at this level of government and to determine the emphasis placed on staying current in public sector and related professional techniques. Item 14 requested a yes/no response to a question concerning the availability of a formal training program, while item 19 requested specific yes/no responses to various statements concerning the perceived emphasis on continued education.

Item number 17 requested the auditor to rank each of a list of qualification standards for prospective



audit staff members in their order of importance in determining eligibility for employment. The ranking mechanism allowed only three possible responses: 'extremely desirable', 'important but not required' and 'not a factor'. The intent was to ascertain the experience and educational background required and the major sources of supply for audit staff members.

Question number 21 requested the responding auditor to check the applicable areas in which additional training could prove beneficial in the performance of scheduled audits. This question's intent was to ascertain if a knowledge of specific procedures and controls was deficient at this level of government and to what extent this deficiency might impinge on the completion of full scope audits.

Item number 22 was designed to determine the use and availability of resource personnel or consultants in the completion of scheduled audits. The purpose of this question was multi-faceted. On the one hand, the author feels that the extensive use and availability of consultants might indicate a progressive attitude on the part of the governmental unit to assure full coverage of a specific functional areas. On the other hand, the use of consultants might negatively relate to the credentials of the auditor and/or the qualifications of his or her staff. In either case, the author's intent was to determine the load on the auditor, the possible funding constraint and the areas in which the local unit felt compelled to augment its audit coverage with additional temporary personnel.

Question number 23 requested a yes/no response from the auditor on how his or her office was viewed as a management training ground in the community. As stated in Chapter II, one of the services that could be performed by





local level audit units related to this area. Since the auditor will become familiar with the operational functions, the accounting controls and the administrative procedures utilized with the community, there can be no better training ground for an ambitious legislator. The intent of this question was to ascertain the perceived use of the audit office to perform this valuable function.

#### d. Audit Performance

Compliance with existing legislation, adequate planning, responsiveness, flexibility to changing circumstances and providing good service to management are essential ingredients for an effective internal audit unit. This section dealt with the audit unit's compliance with the GAO Standards for Audit in general and their use of essential techniques for effective auditing. Questions in this area were designed to elicit information concerning the organizations' utilization of the three levels of internal auditing, the degree of their activity within each level and the probable impediments to the performance of full scope audits at the County and Municipal levels of government. The questions utilized a mix of the nominal and the abbreviated interval scaling technique of measurement, and unless stated below, were not viewed by the author as susceptible to bias.

Item number 6 queried the auditor as to the number of audits scheduled and completed on an average annual basis by his or her office. The purpose of this question was to determine the successfulness of the auditor in completing all scheduled audits. Additionally, the audit load was related to the staff size and, subsequently, to the auditors' ability to achieve full coverage of all required audits.



Question number 11 asked the auditor directly if compliance with the GAO standards was prescribed under a state or local statute or other formal legislative enactment. This question sets the stage for the categorization of the various responding audit units and was used to indirectly determine the capability of the office to comply with the requirement of full scope audits.

Question number 20 requested a yes/no response from the auditor concerning his use in providing line or accounting functions to other governmental offices on a temporary basis. Large organizations utilize this technique as a management development tool for upgrading internal auditors into management assignments. In addition, the ability of the internal auditor and his or her knowledge of the entity is of assistance in performing special studies for management. Thus, the intent of this question was to determine if a trend toward the use of public sector auditors in this way could be discerned or if this valuable principle was accepted at this level of government.

Question number 26 requested the auditor to choose between two statements the one that best described the format of the audit programs utilized by his or her office. Besides giving the author information regarding the actual structure of the community's audit programs, this question provided an insight into the freedom allowed staff auditors during the completion of a scheduled audit. The GAO standards imply that there should be no restrictions placed on the scope of an audit. [5] Thus, it should be the auditor's decision to include or to not include the particular function. This question attempts to reveal the extent to which internal audit units in government remain flexible in the performance of scheduled audits.



Question number 27 requested a yes/no response from the auditor as to their ability to complete scheduled audits of facilities and functions within the required time cycle. The intent of this question was to determine if the office of the auditor was capable of performing those audits required by statutory or other legislative enactments within the established timeframe. That is, due to certain initiatives dealing with grants-in-aid, annual financial audits and bond rating requirements, the size of the audit staff may preclude the completion of scheduled audits and reviews. This question was an attempt to relate these problems to the County and Municipal levels of government.

Item number 28 requested a yes/no response as to the involvement of the auditor in the early development stage of new accounting or control systems. In the author's opinion, the involvement of the auditor during the system development stage is a significant responsibility of management. The early review of in place controls, user needs and the methods utilized to identify requirements can save valuable time in the implementation of required changes. The purpose of this question was to measure the extent to which governmental auditors are utilized in this manner.

Item number 30 requested the responding auditor to rank each item on a list of probable impediments to the performance of full scope audits as to their importance in his or her situation. The scale allowed three possible responses: 'very restrictive', 'restrictive, but not debilitating' and 'not a factor'. The intent of this question was to ascertain the cause or causes of auditing units being unable to comply with the basic GAO tenets. Some bias may exist in this question because of the subjective nature of the information requested. The author feels,





however, that the responses will provide a valuable insight into the perceived impediments to the performance of full scope audits at this level of government.

Question number 32 requires the auditor to choose from a list the statement that best describes the extent of his or her automatic data processing (ADP) audit coverage. Many governmental agencies serviced by the responding County and Municipal auditors utilize a computer in the performance of their work. The ability of the auditor, and/or his staff, to keep up with current computer auditing techniques and controls is and will continue to be an important aspect of an auditor's responsibility. [33:208] Thus, the purpose of this question is to determine the method currently utilized by the auditor to review computer systems and the acceptability of their practices given the current state of the art.

#### e. Reporting Practices

Audit reporting procedures are the means by which the auditor communicates his or her findings to management. Further, they are used by the auditor to persuade management that improvements in specific areas are required. Questions in this section concerned the compliance with the GAO reporting standards, the audit review process, the distribution of audit reports and the degree of acceptance evidenced by the auditee in regards to the findings and recommendations of the auditor. In all cases, the nominal scaling technique of measurement was utilized to allow categorization of the collected data. Questions were straight-forward and objective and, thus, the author feels that the responses do not exhibit an unacceptable degree of bias.





Questions numbered 29 and 31 requested yes/no responses from the auditors as to their specific audit report format and general enclosures. Item 29's intent was to determine the extent to which reports were issued identifying specific weaknesses and recommendations for improvement. Item 31 concerned the inclusion of the noteworthy accomplishments of the auditee in the final audit report. The purpose of these questions was to ascertain the reporting procedures utilized by the responding auditors and to determine whether the reports were constructive in nature and good for the internal relations of the governmental unit while still completing their primary mission.

Questions numbered 33 and 34 utilized the yes/no response format to gather information on the auditor's entrance and exit conference procedures. Since one of the primary purposes of the audit report is communication, item 33 was developed to determine the auditor's procedure in providing the audit findings and recommendations to the auditee prior to the issuance of a final audit report. Item 34 concerned the auditor's willingness to include in the final report the initiated corrective action and the expressed reactions of the audited organization. Both questions were designed to determine the auditor's level of compliance with accepted auditing techniques and to determine if due professional care is generally exhibited in the completion of an audit assignment.

Item number 35 concerns the actions of the auditor in regards to making the final report a product that facilitates action by the auditee. Utilizing the yes/no response format, the question requests additional information on the structure of the report. Specifically, the question asked if a clear and concise summary of the audit findings is included with the final audit report.



Lawrence B. Sawyer indicates that properly drafted report summaries are ideal for executives who want to read no more than they absolutely have to while reserving the right to read the details if they deem it necessary. [7:439] Thus, in the author's opinion, an easy to read summary of audit findings and recommendations may prove to be an effective aid in the implementation of required improvements.

Question number 36 requested the auditor to provide a yes/no response to a statement concerning whether an opinion based upon the audits' findings was generally rendered. An opinion is required in the performance of Level I, financial and compliance, audits, but an opinion does not necessarily need to be given in the other levels of audit. This question was an attempt to ascertain the extent that overall opinions are rendered in governmental audits and whether the evidence contained in the audit report is used as a basis for that opinion.

Item number 37 was designed to determine which activity had the responsibility for reporting the follow-up and corrective action required by an issued audit report. The responding auditors were asked to check the block that applied in their situation - 'the auditor' or 'the audited organization'. The second part of the question was predicated upon an 'auditee' answer to the above inquiry and requested the percentage that replied within established timeframes. The intent of this question was simply to determine who held the feedback responsibility within the Counties and Municipalities. In the author's opinion, the results of this question may indicate an excessive workload on the audit office and the premium the local government places on the audits findings. The final part of this question requested a brief fill-in answer as to the main cause for delays in the release of final audit reports. The



results to this portion of the question will provide an insight into the administrative or political factors that affect the office of the auditor.

Questions numbered 24 and 38 requested the auditor to answer a yes/no and brief fill-in question respectively relating to the degree of supervision and evaluation afforded to the work of the audit staff. Item 24 was directed toward the identification of the individual or group that evaluated the work of the audit staff internally and externally. Item 38 concerned the auditor's review of the working papers compiled by staff members. In both cases, the purpose was to determine the degree of supervision and evaluation of staff audit work evident in County and Municipal audit offices.

Item number 39 provided a yes/no formatted question requesting the auditor to indicate whether audit findings and audit recommendations were generally accepted by the auditee. The intent of this question was to determine if the final audit report facilitated action by the auditee and whether recommendations for improvement were acted upon when received. The answers to these questions are likely to be somewhat subjective, in that without evidence available to the contrary, every auditor may desire to believe that his or her work is well received and utilized by the auditee. However, acceptance and actual action are different functions and it was hoped by the author that this distinction would become evident in the survey results.

Question number 40a requested the auditor to indicate those individuals or groups that generally receive his or her final audit reports. The distribution of audit reports to all activities that have a vested interest or can benefit from the audit's results is encouraged by the GAO standards. This question was an attempt to ascertain the





extent of audit report distribution evident at the County and Municipal levels of government.

Question number 40b requested a brief fill-in answer as to the most serious impediment, as viewed by the auditor, to the growth and development of internal auditing in local government. This question was designed simply to provide a forum for the opinions of the responding auditors on the future and potential of internal auditing at the County and Municipal levels of government within the State of California.

### C. SUMMARY

In this chapter, the author has outlined for the reader the research methodology employed and the basis for its use in support of the thesis effort. Each question utilized in the author developed questionnaire was discussed and an explanation of each questions' purpose, intent and statistical use was presented. Additionally, a review of the questionnaire's sampling techniques was provided to include an explanation of its possible statistical shortcomings.

In the next chapter, the author presents an analysis of the data provided by the responding practitioners. The results captured by the survey questionnaire will be discussed, compared and analyzed. Specifically, the results will be reviewed as they relate to the auditor's compliance with the GAO Standards for Audit, and as they relate to the current status and future potential of internal auditing in local government.



## **V. RESEARCH FINDINGS**

### **A. PREFACE**

The purpose of this chapter is to present an analysis of the data captured by the sampling techniques discussed in the previous section of this thesis. The information gathered by the survey questionnaire mailing will be presented, discussed, compared and analyzed; however, the emphasis of this chapter will be limited to an analysis of the compiled data. Thus, since the responses of the County and Municipal Auditors are, of necessity, kept separate, there has been a conscious attempt by the author to merely present the data and to eliminate inference statements pertaining to the findings.

The reader should be aware that the following presentation of the research findings does not rely on rigorous statistical techniques to present the data content. For ease of understanding and conciseness, the author has chosen to present the findings through the use of descriptive summaries and tables. Specific conclusions and recommendations regarding the current status of internal auditing at the County and Municipal levels of government, as well as the identification of potential problems that confront governmental audit units in the future, has been deferred to the final chapter.

### **B. QUESTIONNAIRE FINDINGS**

The review of the valid responses gathered by the questionnaire has been broken down into the following general topical areas:

#### **1. Degree of Questionnaire Response**



2. Background Data Analysis
3. Organization and Independence Analysis
4. Professional Skills Analysis
5. Audit Performance Analysis
6. Reporting Procedures Analysis

With the exception of the "Degree of Questionnaire Response", the above considerations have been keyed directly to the major topical areas identified in the previous chapter concerning the "Questionnaire's Design".

#### 1. Degree of Questionnaire Response

On 22 March 1982, the questionnaire was mailed to the 58 County audit offices and to 58 randomly selected Municipal audit offices in the State of California. The enclosed letter requested the recipients to review and respond to the questions and to return the questionnaire via a pre-addressed envelope within seven days of its receipt. Through 5 April 1982, the pre-determined cutoff date, the author had received a total of 37 County and 39 Municipal completed questionnaires. Due mainly to time considerations, responses received after this date were not considered in the data presentations that follow.

As mentioned previously, the 58 County questionnaires were mailed to the entire population, statistically speaking, of County audit offices within the State. Of the 37 valid responses that were received, 4 Counties indicated that no audit staff existed in their governmental structure. Although these respondents attempted to answer the questions that they considered relevant to their situation, the author did not record or utilize these responses in the research data presentations. Further, since there are no additional California Counties to sample, and since these 4 questionnaires would not have been mailed





if this fact were known previously, it was the author's decision to reduce the original sample size to 54. This action reflects the fact that these Counties could not provide any information pertinent to the subject area. Thus, the gross County survey response rate was 63.8%. However, after adjusting the sample size downward to 54, the 33 valid County responses resulted in a net survey response rate of 61.1%.

Fifty-eight (58) Municipal audit offices in the State of California received questionnaires. These municipalities were randomly selected via the process described in the previous chapter. Of the 39 responses that were received, 13 municipalities indicated that no audit staff existed in their governmental structure. Again, a few of these respondents attempted to answer questions that they considered relevant to their situation, and, again, the author did not record or utilize these responses in the research data presentations. Since the entire population of municipalities within the State of California is 419, additional questionnaires could have been mailed. However, because of time constraints imposed on the author's research efforts, no attempt was made to sample 13 additional municipalities. Instead, it was the author's decision to reduce the sample size to 45 reflecting an argument similar to that proposed concerning the County questionnaires. Thus, although the gross Municipal survey response rate was 67.2%, the adjustment to the original sample size (45) and to the number of valid responses received (26), resulted in a net response rate of 57.8%.

The computations utilized to determine the gross and net response rate of both the County and Municipal Internal Auditing questionnaires has been provided as Table II. In both cases, the response rate exceeded the expected return





of 40%. Thus, the author believes that statistically discernible inferences can be made regarding the provided data.

TABLE II

Questionnaire Response Rate

	County	Municipal
Total Population	N=58	n=417
Number of Questionnaires Mailed	N=58 or 100%	n=58 or 14%
Number of Questionnaires Returned	37	39
Gross Response Rate	63.8%	67.2%
Number of Questionnaires Mailed	58	58
Adjustments	-4	-13
Revised Sample Size	54 or 93%	45 or 11%
Valid Responses Received	33	26
Net Response Rate	61.1%	57.8%

Note: the use of N in this thesis will represent the number of responses received from the total population and the use of n will represent the number of responses received from a sample drawn from the entire population.

## 2. Background Data Analysis

The findings in the general background area of the surveyed County and Municipal audit offices related to the population of the serviced areas, the length of the auditor's term in office, the total time they have served the community and the type of budget utilized within their governmental units. Information pertaining to these background aspects was provided by questions numbered 1, 2, 3 and 8.

Question number 1 asked: "What is the population of the County/Municipality you serve?", and requested the respondents to check the applicable population range that applied to their service area. The responses received from



the fully completed County and Municipal questionnaires are presented in Table III. However, it is interesting, but only in this case, to look at the four County and thirteen Municipal governments that indicated they did not have an internal audit function. Of the four Counties, one was in the population range 0 - 10,000 while the remaining three annotated the 10,001 - 50,000 range. Of the 13 Municipalities in this grouping, one respondent indicated the 0 - 10,000 range, eleven indicated the 10,001 - 50,000 range and one annotated the 50,001 - 100,000 population range. Thus, it is not merely the smallest communities in the State that currently do not maintain an internal audit division, but also cities in the upper 20 percent based upon their overall population.

TABLE III

Population Ranges - County and Municipal

County (N=33)

<u>Population Range</u>	<u>Actual</u>	<u>Percent</u>	<u>Response</u>	<u>Percent</u>
a. 0 - 10,000	4	7%	1	25%
b. 10,001 - 50,000	17	29%	9	53%
c. 50,001 - 100,000	7	12%	5	71%
d. 100,001 - 500,000	18	31%	11	61%
e. over 500,000	12	21%	7	58%

Municipal (n=26)

<u>Population Range</u>	<u>Actual</u>	<u>Percent</u>	<u>Response</u>	<u>Percent</u>
a. 0 - 10,000	175	42%	0	0%
b. 10,001 - 50,000	164	39%	4	2%
c. 50,001 - 100,000	59	14%	10	17%
d. 100,001 - 500,000	17	4%	9	53%
e. over 500,000	4	1%	3	75%

Note: throughout the remainder of this thesis, references to population ranges will be made by the appropriate letter as designated in this table.



Question number 2 asked: "Are you an Elected or an Appointed official?". On the County questionnaire, 30 respondents or 91 percent indicated that they were elected to a four year term in office. Of the three respondents who indicated that they were appointed to their office, one stated that the appointment was made by the Board of Supervisors while the remaining two indicated that a County Executive made the appointment. On the Municipal questionnaire, the results showed that 23 respondents or 89 percent were appointed to their office; the remaining three respondents were elected to a four year term (all population group 100,001 - 500,000). Twenty Municipal respondents or 77 percent indicated that their appointment was recommended by the City Manager or Administrator and confirmed by the City Council. The remaining municipal auditors indicated that they were appointed via the Civil Service Board or the City's Finance Director.

Question number 3 asked: "Please indicate the length of your term in office and the length of time you have served in your current capacity". In all cases where the auditor responded "appointed" to question number 2, 9 percent (N=3) of County and 89% (n=23) of Municipal Auditors, the length of term was indefinite. Those indicating "elected" in answer to question number 2 responded that their term in office was four years. The overall results assessing the respondents years of auditing service is presented in Table IV. Table IV shows the mean and the population or sample standard deviation, as appropriate, of the number of years the County and Municipal auditors have spent serving their community. The results have been tabulated by elected and appointed respondents.

Question number 8 asked: "What type of budget format is utilized by your County/Municipality?". Ninety-four





Total Auditing Service

a. those elected to office (30) Mean = 8.9 years  
Standard Deviation = 3.7 years

b. those appointed to office (3) Mean = 8.6 years  
Standard Deviation = 5.9 years

a. those elected to office (3)      Mean = 3.3 years  
Standard Deviation = 2.3 years

b. those appointed to office (23)      Mean = 7.9 years  
Standard Deviation = 7.7 years

### 3. Organization and Independence Analysis

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Total Auditing Service

a. those elected to office (30)      Mean = 8.9 years  
Standard Deviation = 3.7 years

b. those appointed to office (3)      Mean = 8.6 years  
Standard Deviation = 5.9 years

a. those elected to office (3)      Mean = 3.3 years  
Standard Deviation = 2.3 years

b. those appointed to office (23)      Mean = 7.9 years  
Standard Deviation = 7.7 years

### 3. Organization and Independence Analysis

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growth, organizational matters and conflicts of interest. Information pertaining to the areas of organization and independence was gathered through survey questions numbered 4, 9, 10, 12, 13, 15, 16, 18 and 25.

Question number 4 asked: "From the list provided, please indicate the position(s) you currently hold within your County/Municipality". Seventy-nine percent (N=26) of the responding County Auditors indicated that they were both the County Auditor and the County Controller. The remaining respondents held various combinations of County Auditor, Recorder, Controller and Clerk. Forty-six percent (n=12) of the responding Municipal Auditors held the title of City Auditor; 27 percent (n=7) held the title Director of Finance and the remaining indicated Auditor-Clerk, Principal Accountant, Auditor-Controller or Controller. The complete results submitted by the responding County and Municipal audit offices are summarized in Table V.

TABLE V

Positions Held by Responding Auditors

<u>County (N=33)</u>	<u>Responses</u>	<u>Percentage</u>
>Auditor-Controller	26	79%
>Auditor-Controller-Recorder	3	9%
>Auditor-Recorder	2	6%
>Auditor-Controller-Clerk	1	3%
>Auditor	1	3%
<u>Municipal (n=26)</u>	<u>Responses</u>	<u>Percentage</u>
>Auditor	12	46%
>Director of Finance	7	27%
>Controller	4	15%
>Auditor-Clerk	1	4%
>Principal Accountant	1	4%
>Auditor-Controller	1	4%

Question number 9 asked the responding auditors to indicate their approximate workload distribution by filling



TABLE VII

## Workload Distribution - Municipal

	<u>Population Range</u>					
	<u>M</u> <u>abc</u>	<u>SD</u>	<u>M</u> <u>d</u>	<u>SD</u>	<u>M</u> <u>e</u>	<u>SD</u>
A. Type of Audit						
>Entity	10%	23	25%	33	72%	4
>Functional	7%	17	14%	21	10%	14
>Special Reviews	17%	34	8%	10	9%	11
>Investigative	2%	4	4%	4	5%	2
>Other	63%	45	49%	49	4%	2
B. Level of Audit						
>Level I	89%	26	78%	27	95%	9
>Level II	5%	9	7%	11	5%	9
>Level III	6%	17	15%	21	0%	0

they report directly to the City Manager or Administrator, the remaining responses were more widely varied. Thus, the Municipal findings concerning this question are summarized in Table VIII.

TABLE VIII

## Reporting Senior - Municipal

<u>Title</u>	<u>Responses</u>	<u>Percentage</u>
>City Manager or Administrator	11	42%
>City Council	6	23%
>Finance Director	5	19%
>Accounting/Audit Manager	2	8%
>Other	2	8%

Question number 12 asked: "Do you maintain, and periodically update, written Conflict of Interest Statements for yourself and/or your audit staff?". Ninety-seven percent (N=32) of responding County Auditors indicated "YES" in answer to this question; the remaining auditor indicated





that these statements were not maintained. The findings from the Municipal questionnaire responses showed 81 percent (n=21) indicating that conflict of interest statements were maintained; the remaining auditors indicated that such statements were not maintained by their municipalities. One responding Municipal Auditor commented on this question. He indicated that the maintenance and update of Conflict of Interest statements was "state mandated". The implication being that 100 percent should have replied "YES" if this comment were true.

Question number 13 asked: "Does your office operate with its own budget appropriation?". One hundred percent (N=33) of the responding County Auditors indicated that they were allocated a separate portion of the overall County budget. However, on the Municipal questionnaire, 81 percent (n=21) responded "YES" to this question, while the remaining 19 percent (n=5) indicated that they received their operating funds from another governmental department. In this instance, all five negative respondents cited the Finance Division or Controller as the source of their funds.

Question number 15 asked: "From which of the following individuals or groups must a staff auditor seek access approval for the data pertinent in the evaluation of an activity under review?". Table IX presents a summary of the findings in this area. From the data provided in the summary, it appears that the County Auditor receives more latitude in this area than do the Municipal Auditors; 19 percent of the cities indicated that the Auditor provided the approval, whereas fully 46 percent of the counties responded in a similar manner. The table provides a complete breakdown of the findings pertaining to this question.

An assessment of various professional and clerical procedures was obtained through question number 16. In this



TABLE IX

## Access Approval

<u>Title</u>	<u>County</u>		<u>Municipal</u>	
	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>
>Auditor	15	46%	5	19%
>Legislative Body	4	12%	1	3%
>The Auditee	11	33%	11	42%
>Board of Supervisors	1	3%		
>Administrative Ordinance	1	3%		
>Finance Director			3	12%
>City Manager or Administrator			3	12%
>Not Applicable	1	3%	3	12%

area, practitioners were asked if they maintained written goals and objectives, published a policy and procedures manual, utilized tailored audit programs and published standards of field work. The findings relating to the variety of written procedures available and not available at these levels of government is summarized in Table X.

TABLE X

## Professional and Clerical Findings

<u>County (N=33)</u>	<u>YES</u>		<u>NO</u>	
	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>
>Written Goals and Objectives	14	42%	19	58%
>Policy and Procedures Manual	20	61%	13	39%
>Tailored Audit Programs	20	61%	13	39%
>Standards of Field Work	9	27%	24	73%
<u>Municipal (n=26)</u>				
>Written Goals and Objectives	19	73%	7	27%
>Policy and Procedures Manual	18	69%	8	31%
>Tailored Audit Programs	10	39%	16	61%
>Standards of Field Work	6	23%	20	77%

Question number 18 asked the responding auditors to choose from three possible alternatives the one that best



described the historical action of their budget or budget share. On the County questionnaire, 46 percent (N=15) indicated their budget was "growing steadily"; 42 percent (N=14) responded "remaining constant" and the remaining four auditors indicated that their budget or budget share was actually "decreasing". The findings from the Municipal questionnaire showed 27 percent (n=7) with a steadily growing budget; 62 percent (n=16) with a budget or budget share that was remaining constant and the remaining three auditors with a decreasing fund allocation.

The final question in this section, question item number 25, asked: "Please indicate the appropriate individual or group that sets audit priorities for your office". Eighty-two percent (N=27) of the responding County Auditors indicated that they, in their position as Auditor, set the priorities for their office; however, only 27 percent (n=7) of the Municipal Auditors responded that they set audit priorities for their office. The complete results gathered from this question are summarized in Table XI.

TABLE XI

Audit Priorities Analysis

<u>County (N=33)</u>	<u>Responses</u>	<u>Percentage</u>
>Auditor	27	82%
>Legislative Body	5	15%
>Not Applicable	1	3%
<u>Municipal (n=26)</u>		
>Auditor	7	27%
>Legislative Body	8	31%
>City Manager	5	18%
>Finance Director	2	8%
>Other	3	12%
>Not Applicable	1	4%





#### 4. Professional Skills Analysis

As mentioned previously, full scope governmental audits require an adequate staff of competent, experienced personnel. The auditor and his or her staff must not only be knowledgeable about auditing and accounting procedures, but they must also be knowledgeable concerning applicable regulatory legislation and current state-of-the-art auditing techniques. The findings in this section concern the qualifications of the auditor and his or her staff, the established employment or eligibility standards, training availability and usage, recognition and the use of consultants. Information was provided by questions numbered 5, 7, 14, 19, 21, 22 and 23.

In question number 5, data was collected from respondents on their professional credentials and on their highest degree earned. These responses have been summarized in Table XII and Table XIII for both County and Municipal Auditors. From the summary, it appears that the majority of respondents do not hold accreditation as Certified Internal Auditor, Certified Public or Chartered Accountant, whereas the majority do possess a college or advanced degree. Thus, on the County questionnaire, 61 percent (N=20) of the respondents indicated that they did not possess one of the listed credentials; 64 percent (N=21) indicated, however, that they held a college or an advanced degree. The results gathered from the Municipal questionnaire showed that 65 percent (n=17) did not possess one of the listed professional credentials, whereas 96 percent (n=25) responded that they held a bachelor or masters degree. Table XII presents a summary of the responding auditor's professional credentials and Table XIII presents a summary of the findings regarding the level of education held by these governmental auditing practitioners.



TABLE XII

## Professional Credentials Held By Auditors

<u>County (N=33)</u>	<u>Responses</u>	<u>Percentage</u>
>Certified Internal Auditor	2	6%
>Certified Public Accountant	4	12%
>Chartered Accountant	1	3%
>California Public Accountant	6	18%
>None	20	61%
<u>Municipal (n=26)</u>		
>Certified Internal Auditor	1	4%
>Certified Public Accountant	6	23%
>Chartered Accountant	1	4%
>California Public Accountant	1	4%
>None	17	65%

TABLE XIII

## Educational Qualifications of Auditors

<u>County (N=33)</u>	<u>Responses</u>	<u>Percentage</u>
>Masters Degree	3	9%
>Bachelors Degree	18	55%
>Associates Degree	2	6%
>None	10	30%
<u>Municipal (n=26)</u>		
>Masters Degree	9	35%
>Bachelors Degree	16	61%
>None	1	4%

Question number 7 requested the responding auditors to provide information on their current staff strength as well as their staff's educational and professional backgrounds. Table XIV and Table XV present a summary of the findings in this area. The information gathered by the questionnaire is categorized by the population of the respective Counties and Municipalities, and, as before,



governmental units with populations under 100,000 are grouped for concise data presentation. Once the groupings are established, the mean and population or sample standard deviation has then been tabulated within each population range.

TABLE XIV

Staff Size and Qualifications - County

	<u>Population Range</u>					
<u>Auditors</u>	<u>M</u> <sup>abc</sup>	<u>SD</u>	<u>M</u> <sup>d</sup>	<u>SD</u>	<u>M</u> <sup>e</sup>	<u>SD</u>
>Total Number	2.8	3	6.2	4	21.3	24
>Bachelors Degree	1.7	2	4.8	3	20.6	24
>Masters Degree	.1	.5	.4	.6	1.3	1
>Public Accountant	.1	.3	1.3	1	3.4	4
>Internal Auditor	0	0	.4	.5	2.0	2
<u>Other Professionals</u>						
>Total Number	.1	2	3.7	6	11.5	25
>Bachelors Degree	.4	1	1.9	3	11.2	25
>Masters Degree	0	0	0	0	0	0
>Public Accountant	0	0	0	0	0	0
<u>Clerical</u>						
>Total Number	5.7	5	7.7	8	43.9	95

Question number 14 asked: "Does your County/Municipality provide a formal training program for you and/or your staff auditors?". Twenty-four percent (N=8) of the responding County Auditors indicated "YES" in answer to this question; the remaining seventy-six percent (N=25) responded that a formal training program was not provided to them or their staff. On the Municipal questionnaire, 46 percent (n=12) indicated that their municipality provided the staff a formal training program, whereas, conversely, 54 percent (n=14) indicated that a formal training program was not offered.



TABLE XV

## Staff Size and Qualifications - Municipal

	<u>Population Range</u>					
	<u>M</u> <sup><u>abc</u></sup>	<u>SD</u>	<u>M</u> <sup><u>d</u></sup>	<u>SD</u>	<u>M</u> <sup><u>e</u></sup>	<u>SD</u>
<u>Auditors</u>						
>Total Number	.4	.7	1.2	2	6.0	9
>Bachelors Degree	.4	.7	1.2	2	4.0	6
>Masters Degree	0	0	0	0	.5	.7
>Public Accountant	0	0	0	0	.5	.7
>Internal Auditor	0	0	0	0	.5	.7
<u>Other Professionals</u>						
>Total Number	1.2	1	3.8	5	5.5	6
>Bachelors Degree	.7	.8	1.8	3	5.0	7
>Masters Degree	.2	.4	.5	.8	0	0
>Public Accountant	0	0	0	0	0	0
<u>Clerical</u>						
>Total Number	4.7	5	4.8	7	.5	.7

Question number 17 asked responding auditors to rank each of a list of possible qualification standards in their order of importance in determining the eligibility of prospective staff members. The results gathered by this question are summarized in Table XVI. Note that there were three possible ranking levels: (a) extremely desirable, (b) important, but not a deciding factor and (c) not considered necessary. Those possible levels correspond to the a, b and c headings utilized in the summary table.

Question number 19 probed the tendency of the responding auditors and their staffs to remain current in their field by requesting information concerning their attendance at professional seminars, automatic data processing courses, continuing education and CPA/CIA certification classes. Table XVII presents a summary of the data provided by the respondents.





TABLE XVI

## Staff Qualification Standards

<u>County (N=33)</u>	<u>A</u>	<u>B</u>	<u>C</u>
>Corporate Accounting Experience	0%	36%	64%
>College Degree in a Related Field	46%	35%	19%
>CPA/CIA Credentials	17%	50%	23%
>Public Sector Accounting Experience	31%	50%	19%
>Internal Auditing Experience	35%	50%	15%
<u>Municipal (n=26)</u>			
>Corporate Accounting Experience	0%	19%	81%
>College Degree in a Related Field	54%	35%	11%
>CPA/CIA Credentials	15%	58%	27%
>Public Sector Accounting Experience	42%	42%	16%
>Internal Auditing Experience	42%	50%	8%

TABLE XVII

## Available Training Utilization

<u>County (N=33)</u>	<u>Responses</u>		<u>Percent</u>
	<u>YES</u>	<u>NO</u>	
>Professional Seminars	30	3	94%
>ADP Courses and Seminars	22	11	69%
>Continuing Education	20	13	63%
>CPA/CIA Certification	14	19	44%
<u>Municipal (n=26)</u>			
>Professional Seminars	21	5	81%
>ADP Courses and Seminars	15	11	58%
>Continuing Education	20	6	77%
>CPA/CIA Certification	6	20	23%

Question number 21 asked the responding auditors to indicate, from a provided list, the areas in which they and their staff could most benefit from additional training. Since more than one area could be checked, the findings of this question represent the percentage of auditors that felt a particular subject area could be helpful to their



situation. Thus, each of the six possible answers will be treated as if it were a separate question and the results tabulated as if each area was in a YES/NO format. Table XVIII presents a complete summary of the gathered data concerning this question.

TABLE XVIII

Additional Training Requirements

<u>County (N=33)</u>	<u>Number YES</u>	<u>Percent YES</u>
>Audit Procedures and Standards	9	27%
>Accounting Systems Review	21	64%
>ADP Control	24	73%
>Applicable Laws and Regulations	10	30%
>Resource Management	12	36%
>Government Program Objectives	7	21%
<u>Municipal (n=26)</u>		
>Audit Procedures and Standards	8	31%
>Accounting Systems Review	10	39%
>ADP Control	14	54%
>Applicable Laws and Regulations	5	19%
>Resource Management	5	19%
>Government Program Objectives	6	23%

Question number 22 asked: "Does your office make use of consultants in the completion of scheduled audits?". Thirty-three percent (N=11) of the responding County auditors indicated that their auditing units utilized the services of consultants; the remaining 67 percent (N=22) did not utilize consultants in the normal completion of scheduled audits. On the Municipal questionnaire, the findings in this area showed 54 percent (n=14) utilizing consultants in the completion of audits, whereas the remaining 46 percent (n=12) did not make use of such services.

The final question assessing the professional skills area, question number 23, asked responding auditors to



indicate whether their office was recognized and used as a training ground for higher level governmental positions. On the County questionnaire, 33 percent (N=11) indicated that their office did provide personnel for higher level positions; 61 percent (N=20) responded negatively while the remaining six percent (N=2) answered both yes and no. Thirty-five percent (n=9) also indicated a positive response to this question on the Municipal questionnaire. Sixty-two percent (n=16) responded that they did not feel that their office was recognized for this purpose and one respondent (3%) indicated an answer of "not applicable".

##### 5. Audit Performance Analysis

Compliance with existing legislation, adequate planning, responsiveness, flexibility to changing circumstances and providing good service to management are essential ingredients for an effective internal audit unit. The findings in this section concerned the aspect of compliance with the General Accounting Office (GAO) Standards for Audit; the utilization of the auditor in areas other than auditing; the unit's audit program format; the perceived impediments to full scope audits; scheduling; planning; internal controls and computer audit involvement. Data pertaining to these areas were gathered through survey questions numbered 6, 11, 20, 26, 28, 30 and 32.

Question number 6 asked: "How many audits are scheduled and completed by your office annually?". This was one of only two questions on either survey that was left blank by a portion of the responding County and Municipal Auditors. The requested information was provided by 27 out of 33, 82 percent, of the responding County Auditors; only 12 or 46 percent of the responding Municipal Auditors, however, provided the information requested in this





question. For this reason, the Municipal data will not be presented as it does not contain sufficient data to make relevant inferences by population group. The data provided by the County Auditors is, therefore summarized in Table XIX. Again, a mean is provided for each population range along with the appropriate population standard deviation.

TABLE XIX

Scheduled and Completed Audits - County

	<u>Responses</u>	<u>Scheduled</u>		<u>Completed</u>	
		<u>M</u>	<u>SD</u>	<u>M</u>	<u>SD</u>
a. 0 - 100,000	10	17.7	11.1	17.4	10.9
b. 100,001 - 500,000	10	57.8	51.1	54.7	49.5
c. over 500,000	7	114.3	82.7	99.7	66.7

Questionnaire item number 11 asked: "Is your compliance with the GAO Standards for Audit prescribed, rather than implied, under a state or local statute or other formal legislative enactment?". Thirty-six percent (N=12) of the responding County Auditors indicated that their compliance was mandated by a formal legislative initiative; the remaining 64 percent (N=21) responded negatively to this question. On the Municipal questionnaire, 27 percent (n=7) indicated that their compliance with the GAO Standards was mandated in this manner, while the remaining 73 percent (n=19) responded negatively. Additionally, three Municipal auditors noted in the questionnaire's margin that their compliance was required under an inclusion in their City Charter.

Question number 20 asked: "Are you and/or members of your staff called upon to provide assistance on a temporary basis to a line or accounting function?". The data provided



by the responding County auditors indicated that 88 percent (N=29) were required to act in a capacity other than Auditor; conversely, the remaining four auditors indicated they were not called upon in this manner. The data gathered with the Municipal questionnaire showed 65 percent (n=17) providing services to a line or an accounting function, whereas 35 percent (n=9) responded negatively. Again, two auditors provided additional information concerning this question in the questionnaire's margin. In both cases, the auditors indicated that their Internal Control policies did not allow them to provide any service other than auditing to their municipality.

Item number 26 requested responding auditors to choose between two statements the one that best described the format of their audit programs. Thirty-nine percent (N=13) indicated that the statement "detailed audit steps" best described their office's audit programs. Fifty-two percent (N=17) responded that the statement "broad and general with additional steps designed on the job" best described the audit programs they utilized. One auditor responded that both are used to some extent and the remaining two responded that neither statement described his or her County's audit programs.

On the Municipal questionnaire, 42 percent (n=11) of the respondents indicated that the statement which best described their audit programs was "detailed audit steps". Forty-six percent (n=12) indicated that their programs were mainly composed of broad and general steps with additional steps designed during the audit. The remaining respondents (n=3) indicated that this question was "not applicable" to their situation.

Question number 27 asked: "Are you and/or your staff able to cover the scheduled audits of facilities and



functions within the required time cycle?". Fifty-two percent (N=17) of the responding County auditors indicated "YES" in answer to this question; 39 percent (N=13) responded "NO" and three auditors indicated that this question was "not applicable" to their audit organization. The data provided on the Municipal questionnaire showed 50 percent (n=13) of the respondents answered "YES" to this question; 23 percent (n=6) responded "NO" and the remaining seven completed Municipal questionnaires indicated that this question was "not applicable" to their situation.

Questionnaire item number 28 asked: "Do you and/or your staff become involved in reviews of new systems (accounting, control, ADP, etc.) early in their development stage?". Seventy-nine percent (N=26) of the 33 responding County Auditors answered this question "YES"; the remaining seven or 21 percent did not become involved in new systems development. On the Municipal questionnaire, 73 percent (n=19) answered this question affirmatively; 23 percent (n=6) indicated that they did not become involved in the systems development phase and the remaining auditor responded "not applicable" to this question.

Question number 30 requested the auditors to rank each of a possible list of impediments to the performance of full scope audits in accordance with a given three point scale. The first point equated to "extremely restrictive", the second to "restrictive, but not debilitating" and the third point on the scale represented "not a factor". The findings regarding this question are summarized for the County respondents in Table XX and for the Municipal Auditors in Table XXI.

The final question in this area, question number 32, requested responding auditors to indicate, from a given list, the statement(s) that best described the extent of





TABLE XX

## Impediments to Full Scope Audits - County

<u>Possible Impediments</u>	<u>Ranking</u>		
	<u>A</u>	<u>B</u>	<u>C</u>
>Need for additional staff	41%	41%	18%
>Need for additional funding	36%	46%	18%
>Need for additional training	27%	55%	18%
>Statutory Requirements-Level I	21%	33%	46%
>Overlap of Responsibilities	18%	27%	55%
>Legislative Requirements	9%	61%	30%
>Bond Rating Requirements	3%	12%	85%
>Lack of Management Support	12%	30%	58%

TABLE XXI

## Impediments to Full Scope Audits - Municipal

<u>Possible Impediments</u>	<u>Ranking</u>		
	<u>A</u>	<u>B</u>	<u>C</u>
>Need for additional staff	50%	23%	27%
>Need for additional funding	46%	23%	31%
>Need for additional training	35%	50%	15%
>Statutory Requirements-Level I	0%	35%	65%
>Overlap of Responsibilities	15%	12%	73%
>Legislative Requirements	23%	27%	50%
>Bond Rating Requirements	0%	31%	69%
>Lack of Management Support	15%	31%	54%

their Automatic Data Processing audit involvement. The auditors could check more than one of the given statements if they applied to their particular situation. Thus, each question will be treated in a yes/no format and the findings tabulated in this manner. The data gathered from this question is presented in Table XXII for both County and Municipal respondents.





TABLE XXII

## ADP Audit Coverage Findings

<u>Possible Answers</u>	<u>County</u>		<u>Municipal</u>	
	<u>YES</u>	<u>%</u>	<u>YES</u>	<u>%</u>
a. Audit around the computer	10	30%	10	39%
b. Audit computer controls	14	42%	14	54%
c. Review operations and controls	19	58%	10	39%
d. Audit applications on request	12	36%	6	23%
e. Audit through the computer	5	15%	4	15%
f. Do not conduct ADP audits	14	42%	3	11%

6. Reporting Procedures Analysis

Audit reports are the means by which the auditor communicates his or her findings, observations, conclusions and recommendations to higher level management. Further, they are used to persuade management that improvements are required. The results compiled in this section concern the audit review process; the final report content; the use of evidence in rendering opinions; the final report's timeliness; the degree of supervision evident; the distribution of the final report; the degree of acceptance of audit findings and the feedback or follow-up process by which noted deficiencies are corrected and recommendations acted upon. Additionally, a special question was included in this final section that allowed the auditors the opportunity to comment on the most serious impediment, as viewed from their position, to the growth and development of internal auditing in local level government. Information pertaining to this area was gathered through the use of questions numbered 24, 29, 31, 33, 34, 35, 36, 37, 38, 39 and 40.

Question number 24 asked: "By whom is the performance of your audit staff evaluated: internally? and



externally?". One hundred percent (N=33) of the County Auditors responding to the questionnaire answered this question in its entirety; whereas, 77 percent (n=20) of the responding Municipal auditors provided the requested information. On the County questionnaire, all responding practitioners indicated that the "Auditor" evaluated the staff internally. Forty-five percent (n=9) of the responding Municipal Auditors cited the Finance Director or Controller as the internal evaluator; 30 percent (n=6) cited the Auditor; one auditor indicated the City Manager while the remaining four responded "not applicable". Concerning external evaluations, 55 percent (n=11) of the responding Municipal Auditors indicated that independently contracted auditors evaluated their staff; five percent (n=1) indicated that the City Council was their evaluator; the remaining respondents (n=8) answered this question with the statement "not applicable". The summary of findings on the County external evaluations is provided in Table XXIII.

TABLE XXIII

External Evaluations - County

<u>Response</u>	<u>Number</u>	<u>Percent</u>
>Independent Auditors	22	67%
>Grand Jury	4	12%
>Constituency	2	6%
>Board of Supervisors	2	6%
>State/Federal Agencies	1	3%
>Not Applicable	2	6%

Questionnaire item number 29 asked: "Are reports issued identifying weaknesses and recommendations for improvement?". Eighty-five percent (N=28) of the County Auditors participating in this research effort answered "YES" to this question; the remaining five auditors (15%)



indicated that final reports of this type were not issued. On the Municipal questionnaire, 89 percent (n=23) responded "YES" while only three auditors responded negatively to this question.

As a question designed to compliment the previous item, question number 31 asked: "Do your audit reports regularly include the noteworthy accomplishments of the auditee?". In this area, the County Auditors were split equally: 46 percent (N=15) indicated "YES" while 54 percent (N=18) indicated that their reports did not include noteworthy accomplishments. The findings gathered on the Municipal questionnaire, however, were more varied in that 35 percent (n=9) indicated "YES" in response to this item; 46 percent (n=12) responded negatively and the remaining five auditors answered "not applicable".

Question number 33 asked: "At the conclusion of an audit assignment, do you and/or your auditors meet with representatives of the audited organization and discuss the findings and recommendations before issuing a final audit report?". The findings provided in answer to the County questionnaire indicated that 85 percent (N=28) followed this procedure; the remaining respondents (N=5) indicated that these meetings were not in their routine procedures. Seventy-three percent (n=19) of the responding Municipal Auditors indicated "YES" in answer to this question; 11 percent (n=3) responded "NO" while the remaining four respondents cited that this question was "not applicable" to their situation.

Question number 34 asked: "Is it your practice to include in the final audit report the expressed reactions of the audited organization and some indication of the follow-up and corrective action they intend to initiate?". On the County questionnaire, 49 percent (N=16) of the





responding auditors indicated that this practice was utilized by their audit organizations; 39 percent (N=13) responded negatively while four answered this question as "not applicable" to their unit. Sixty-five percent (n=17) of the Municipal auditors answering this question provided an affirmative answer; 15 percent (n=4) responded "NO" while the remaining five auditors indicated that this procedure was "not applicable" to their situation.

Item number 35 asked: "Are summaries of audit findings included with the final audit report?". Twenty-three County respondents, or 70 percent, indicated that summaries of audit findings were regularly included in their issued final reports; six respondents answered negatively to this question and the remaining four auditors indicated that this question was "not applicable" to their standard operating procedures. The data gathered from the Municipal questionnaire shows 69 percent (n=18) of the respondents answering affirmatively to this inquiry; 19 percent (n=5) indicated that summaries of findings were not included in the final audit report and the remaining three respondents answered "not applicable".

Question number 36 asked: "Is an overall opinion given in the final audit report based upon the audit findings?". Eight-eight percent (N=29) of the responding County Auditors indicated that opinions were expressed in this manner. Only one auditor indicated "NO" in answer to this question while three offered "not applicable". On the Municipal questionnaire, 89 percent (n=23) responded "YES"; one auditor responded "NO" and two auditors indicated that this question was "not applicable" to their audit unit.

Questionnaire item number 37 required, at most, three separate answers from responding auditors. Part one of this question, concerning who had the primary responsibility



for reporting the follow-up or corrective action taken after the release of the final audit report, was answered by 100 percent of the respondents to both questionnaires. Part two of the question, predicated upon an answer of the "auditee" to part one, asked what percentage responded within the established timeframe; 100 percent of the respondents to both questionnaires also answered this portion of the question. Part three, asking what they viewed as the main cause for the delay in the release of the final audit report, was answered by 67 percent of those County Auditors that indicated an answer to part two and fifty percent of the Municipal Auditors that indicated a delay was prevalent. The summary of the findings to this question is presented in Table XXIV and Table XXV.

TABLE XXIV

Follow-up Reporting Responsibility

<u>County</u>	<u>Responses</u>	<u>Percent</u>
> Auditor	9	27%
> Auditee	21	64%
> Not Applicable	3	9%
<u>Municipal</u>		
> Auditor	14	54%
> Auditee	10	39%
> Not Applicable	2	7%

Question number 38 asked: "Do you periodically review the working papers compiled by your staff?". Eight-five percent (N=28) of responding County Auditors indicated "YES" in answer to this question; one auditor indicated "NO" in answer to this question, while the remaining four auditors responded that this question was "not applicable" to their governmental unit. In assessing



TABLE XXV

## Report Delinquency Rate/Cause Findings

County (22)

Mean Delinquency Rate: 72%  
 Standard Deviation: 3%

<u>Cause</u>	<u>Responses</u>	<u>Percent</u>
>Review Procedures	5	23%
>Lack of Pressure	4	18%
>Workload	5	23%
>Budgetary Constraints	1	5%
>No Comment	7	31%

Municipal (10)

Mean Delinquency Rate: 87%  
 Standard Deviation: 10%

<u>Cause</u>	<u>Responses</u>	<u>Percent</u>
>Review Process	4	40%
>Staffing Limitations	3	30%
>No Comment	2	20%
>Disagreements on Findings	1	10%

the responses provided by the Municipal Auditors, 85 percent (n=22) indicated that it was their practice to review the working papers of their staff; the remaining four respondents indicated that this question did not apply to their situation.

Questionnaire item number 39 requested information concerning the acceptance of both the audit findings and the recommendations for improvement by the auditee. The findings pertaining to this question were overwhelmingly positive:

## County (N=33):

Audit Findings Accepted? 88% YES  
 Audit Recommendations Accepted? 73% YES

## Municipal (n=26)

Audit Findings Accepted? 89% YES  
 Audit Recommendations Accepted? 89% YES





Of the remaining County auditors, one auditor indicated that audit findings were not accepted by the auditee, while three answered the question "not applicable". Of the remaining Municipal Auditors, only one cited "NO" in answer to both portions of this question; while the remaining two indicated that the question did not apply to their audit organization.

Part one of question number 40 requested data on those individuals or groups who generally receive copies of the final audit reports issued by the surveyed County and Municipal audit offices. One hundred percent of both groups provided answers to this question, however, in answering the responding auditors could indicate more than one individual or group as receivers of reports. Thus, for clarity, each of the seven possible answers will be treated and tabulated as if it were in a YES/NO format. Table XXVI presents the summary of the data gathered concerning this area of the research effort.

TABLE XXVI

Final Report Distribution

<u>Response</u>	<u>County</u>		<u>Municipal</u>	
	<u>YES</u>	<u>%</u>	<u>YES</u>	<u>%</u>
>Media Representatives	3	9%	4	15%
>Chief Executive Officers	26	79%	18	69%
>Legislative Bodies	26	79%	16	62%
>Higher Units of Government	11	33%	6	23%
>Chief Fiscal Officers	8	24%	13	50%
>Controllers	5	15%	9	35%
>Other	14	42%	12	46%
>Not Applicable	2	6%	3	12%

The final question on both questionnaires requested the responding auditors to indicate what is, in their view, the most serious impediment to the growth and development of auditing in local level government. The data provided by





respondents has been combined and provided in summary form as Table XXVII.

TABLE XXVII

Growth and Development Findings

<u>Response (51)</u>	<u>Number</u>	<u>Percent</u>
>Lack of Funding	24	47%
>Staffing Constraints	13	26%
>Lack of Mgt. Understanding	14	28%
>Lack of Proper Training	5	10%
>Other	5	10%

Note: Some responding auditors indicated more than one restrictive causal factor.

### C. SUMMARY

This chapter has presented the reader with the findings gathered by the author developed internal auditing County and Municipal questionnaires. The data provided by respondents was presented, discussed and compared. However, the emphasis of this chapter was purposely limited to a presentation of the compiled data without the possible inferences that could be drawn from the information.

In the next, and final chapter, the author analyzes the results, develops conclusions and makes recommendations based upon the findings provided by the survey questionnaire. These conclusions and recommendations have been directly related to the thesis objectives as well as to the current status and future potential of internal auditing at the County and Municipal levels of government.



## VI. CONCLUSIONS AND RECOMMENDATIONS

### **A. PREFACE**

The purpose of this thesis was to analyze the extent to which the concepts and techniques of the United States General Accounting Office (GAO) expanded scope audit standards were currently being utilized within the County and Municipal governments in the State of California. The specific objectives, established in Chapter I, were:

1. To determine the degree of compliance with the GAO expanded scope audit standards;
2. To determine the underlying cause or causes of non-compliance; and
3. To make recommendations designed to improve the effectiveness of local level governmental internal auditing.

To help the reader appreciate and gain a perspective on the research objectives, the author provided a background discussion pertaining to auditing in general. Specifically, a brief history of internal auditing in the private and public sectors was presented so that the reader could better evaluate the critical aspects of effective internal auditing organizations that followed in subsequent chapters. Special emphasis was placed upon a discussion of the emergence of auditing in local government and the need for public sector auditors to provide timely performance information.

Following this presentation, the author sought to specify what internal auditing should be designed to accomplish by providing the reader with a standard of measurement by which to judge the current effectiveness of auditing units in California's county and municipal governments. Further, the author presented a thorough



discussion of the GAO levels of audit and of each tenet of the GAO expanded scope audit standards. This section of the thesis sought to convey to the reader a sense of the actual methodology, techniques and requirements of auditing in order to provide a perspective on the growth and development potential of public sector auditing. The thrust of this presentation was directed towards providing the reader an insight into the sound principles that are available to guide the actions of governmental auditors.

An indepth discussion of the author's research methodology was then provided to display the data gathering tools utilized to support the central thesis direction. Essentially, the author presented a comprehensive overview of the method employed to determine the degree of compliance evident with the GAO Standards at these levels of government. Further, this section provided the reader with a thorough discussion concerning the design, purpose and intent of each question in an author developed questionnaire utilized to gather data relevant to the subject.

Following this discussion, the author presented the actual research findings. The information captured through the previously discussed sampling techniques were displayed in a non-rigorous statistical manner. A conscious effort was made up to this point to refrain from making inference statements or statements regarding the statistical significance of these findings.

The effect of the preceding five chapters was to illustrate to the reader the proper auditing structure that, when combined with the operative and essential procedures and techniques, offers the best prospect of producing an effective governmental auditing function. Thus, the purpose of this final chapter will be to present an analysis of the data gathered by the survey questionnaire; to present the





authors conclusions relating to the purpose and objectives of the thesis; and to present the authors recommendations that directly concern the future potential of internal auditing in local government.

## B. ANALYSIS

### 1. General

The author will now analyze the findings, issues and problems raised by the completed survey effort. In order to accomplish this goal, the analysis will be broken down into four topical areas that directly concern the purpose and objective of this thesis. These areas are:

1. Qualifications,
2. Independence,
3. Competence, and
4. Compliance.

The actual survey results presented in the previous chapter will form the basis of discussion in each of the above areas. Since the reader may find it advantageous to refer back to the survey findings, it is recommended that the key to the internal auditing questionnaire, provided as Table I, be utilized for more expeditious referencing.

### 2. Qualifications

Governmental internal auditing departments should collectively possess the knowledge, skills and disciplines required to complete their audit responsibilities. For example, internal auditors who work extensively with financial records and reports should be proficient in accepted accounting principles and techniques. This is, of course, true for all other functional areas under audit consideration. Auditors should be able to apply their



expertise to situations that they encounter and to be able to deal with them without extensive recourse to technical research and assistance. Thus, the internal auditing organization should meet the following standards:

1. Internal auditors should meet prescribed standards of educational background and audit experience;
  2. A significant percentage of the staff should be professionally certified;
  3. Internal auditors should be active in current professional, business, accounting and auditing training courses; and
  4. Internal auditors' performance should be periodically reviewed to assess their strengths and weaknesses.
- [7]

The following discussions will utilize these standards as a measure of assessing the qualifications of County and Municipal auditing units in the State of California.

The State of California stipulates that no person shall be elected or appointed to the office of auditor unless:

1. He possesses a valid certificate issued by the California State Board of Accountancy showing him to be a certified public accountant or a public accountant; or
2. He possesses a valid certificate or diploma of graduation from a school of accountancy; or
3. He has served as auditor for a continuous period of not less than three years prior to the passage of this legislation (1963). [11:26945]

The survey findings indicate that the great majority of County (61%) and Municipal (65%) auditors do not hold professional certification, however, the majority do possess a bachelors or masters degree in accounting or have served in excess of the three year requirement. In this regard, the Municipal auditors seem to have the better qualifications in terms of currency; 96% hold a college or advanced degree while the length of their service had a mean of 3.3 years for elected and 7.9 years for appointed officials. Although 70% of the County auditors possessed a bachelors or masters



degree, they tended to rely more heavily on their experience. The average elected County auditor has served nearly 9 years in office, while the mean for those appointed was 8.6 years.

The survey indicates that staff size and qualifications are directly related to the population of the community served (see Table XIV). Although a college or advanced degree is often cited as a prerequisite of employment, certification as a public accountant or internal auditor does not seem to be required. Standards of employment are similar for both groups; the majority citing a college degree, public sector accounting experience and internal auditing experience as the most desirable qualifications in determining the eligibility of prospective staff members. While a significant percentage of the audit staffs do not appear to be certified, the GAO standard addressing the need to have an audit unit that collectively possesses adequate professional proficiency for the task required appears to have been fully met at these levels of government.

In the area of available training utilization, formal training programs do not appear to be provided to either group to any extent. However, the majority of responding auditors attempt to remain current in auditing techniques by attending professional seminars and continuing education courses. As discussed previously, the need to stay current in these areas is extremely important to the future growth of public sector internal auditing. Formal training programs, in the view of two respondents, cannot be provided to elected officials due to their short term of office, budgetary constraints and audit workload. The availability and the auditors participation in professional seminars, however, indicates an increasing emphasis being placed upon this area.





Further, a survey question was asked concerning the areas in which the responding auditors and their staffs could most benefit from additional instruction. In this area, only two functions received overwhelmingly affirmative answers: accounting systems review and automatic data processing (ADP) controls. The first subject was thoroughly introduced and discussed in Chapter III and requires that the auditor be familiar with the organization's overall strategic planning situation. The second item has undoubtedly grown from the increased dependence upon computers in all sectors of public and private operations. Table XXII summarizes the ADP audit coverage findings and indicates that the trend toward computer use will require greater knowledge on the subject from future governmental auditors.

Evaluating the performance of the auditors and their staffs is a function that can easily be overlooked in the public environment. The responses from the County and Municipal auditors, however, indicate that their work and that of their staff are periodically reviewed both internally and externally. The internal evaluations are conducted in accordance with the prevailing organizational structure of the governmental unit. That is, county auditors perform the internal evaluations, while municipal auditors are evaluated by either the auditor, the Director of Finance or the Controller depending upon the units placement within the organization. In both groups, external evaluations are predominantly accomplished by independently contracted auditors. In any case, there is ample opportunity to provide assistance to the auditors and their staff with the proper direction and initiative required to accurately review and complete their duties.





These evaluations would be difficult to perform if specific standards were not available to measure staff performance. In this area, the availability of written goals and objectives, a policy and procedures manual and standards of field work would greatly aid the evaluator in the completion of his or her duties. In both County and Municipal audit units, the existence of field work standards seems to be indicative of the units desire to project a professional image during the audit function. However, in the remaining areas mixed results were received. Although a majority of the counties maintained written goals and objectives, very few municipalities provided similar documentation. Further, only one third of county and municipal audit units had a local policy and procedures manual. Overall, the prevalent situation does not appear to be consistent with accepted clerical and professional documentation procedures.

### 3. Independence

Internal auditors should be provided with sufficient 'practical' independence to allow them to complete their work freely and objectively. This independence, in perception and appearance, permits auditors to render the impartial and unbiased judgements and opinions essential to the proper conduct of governmental audits. Practical independence is achieved through segregation of duties, organizational status and objectivity. Proper segregation of internal governmental duties is required to assure that conflicts of interest do not interfere with the auditors performance. The organizational status of the auditing unit should be sufficient to permit the accomplishment of the required audit responsibilities. Objectivity requires internal auditors to have a certain level of belief in their



work such that no significant compromises are evident in their findings and opinions.

In addition to the above measures of independence, Lawrence B. Sawyer lists the following standards that internal auditors should be able to meet:

1. The auditor should be responsible to an individual in the organization with sufficient authority to promote independence, broad audit coverage, full consideration of audit reports and action on audit recommendations; and,
2. The purpose, authority and responsibility of the auditing unit should be defined in an formal written document (charter). This document should establish the units position in the organizational structure; authorize access to records and personnel relevant to the performance of audits and define the scope of audit activities. [7]

The following discussions will utilize these standards and the listed measures of practical independence as a means of assessing the performance of County and Municipal audit units in the State of California.

#### a. Segregation of Duties

Every County and Municipal practitioner that responded to the survey held another governmental office other than Auditor. The completion of these related, yet subsidiary, tasks do not appear to be consistent with an acceptable level of job segregation. County auditors serve as Chief Financial Officer of their county and answer to the electorate. While holding this office, however, they can concurrently hold office as Controller, Recorder, Clerk or any combination thereof. Each of these positions carry responsibilities that provide a basic inconsistency with an independent audit function. Thus, the accomplished tasks in each area are subsequently audited by the same individual. That is, the auditor reviews his or her own work in these other areas. One County auditor commented that his dual office situation did not inhibit his actions to



independently appraise his governmental units performance. However, Sawyer states that:

"The standards point out the need for 'practical independence'...a concerted effort must be made to see that internal auditors are perceived to be independent of the activities they audit." [7:41]

The prevalent situation in the counties of California does not appear to be consistent with this attitude.

Municipal auditors can boast more of this perceived independence as nearly half of those responding to the survey held no position other than Auditor in their organization. In this case, however, the reason can probably be traced to financial and workload considerations; note the following:

1. Every municipal auditor in this category came from a city of over 100,000 inhabitants; and
2. Those municipal auditors providing data in answer to question number 6, cited consistently higher numbers of scheduled and completed audits.

Additionally, it is interesting to note that those holding office as the Director of Finance had a separate auditing division under their control. Certainly, this situation is also superior to that of the county organizational structures.

#### b. Organizational Status

In order to assure that line personnel in government understand the internal auditors authority and responsibility, their status within the organizational structure should be set forth in writing. Further, they should report to an individual with sufficient authority to allow the findings, conclusions and recommendations of the audits they perform to be generally accepted and acted upon by the auditee. Although a written charter, approved by the County or Municipal chief executive officer, would probably





not be offered to governmental auditors, adequate protection can be indicated by other factors. These factors are included in the survey findings relating to the reporting senior, budget considerations, the setting of audit priorities, the acceptance of audit findings and recommendations and the perceived use of the auditing unit as a training ground for higher level offices.

The survey findings in the reporting senior area highlight differences between the County and Municipal governments in the State of California. Although a majority (52%) of the county auditors indicated that the Board of Supervisors acted as their reporting senior, nearly half (42%) cited their electorate in answer to this question. As predominantly elected officials, the latter answer should have been unanimous. Yet, the insistence upon a reporting individual or group seems to indicate a lack of perceived independence. Similar results were obtained from the Municipal respondents, however, the reasons seem to be totally different. The municipal auditors are predominantly appointed. Thus, there may be a dependence in the relationship between the reporting senior, the individual or group that made the appointment and the auditor. Municipal auditors seem to be afforded the appearance of independence, but they too lack the internal perception of being an independent entity.

Another area in which the question of independence can be argued concerns the availability of audit funds. County auditors unanimously responded that they were allocated a separate portion of the overall county budget and 81% of the municipal auditors responded similarly. The remaining municipal auditors receive audit funds from another department since they are a division under, generally, the office of the Director of Finance. Of



more significance, however, is the fact that a solid majority of both groups indicated that their budget or budget share was remaining constant or actually decreasing. This trend could be disastrous, in that governmental auditing could be slowly relegated to an insignificant position within the local governmental organization. Although generally given their own funds, growth can be stifled with inflation decreasing the audit purchasing power of the individual budgets.

An essential ingredient to the independence of a governmental auditing unit is the auditors ability to set his or her own priorities. As previously discussed, the great majority of audits performed at these levels of government are dictated by state or federal law, however, there should be no further restrictions placed upon the auditors scope. That is, as the need dictates, any area of the organization should be open to audit or review. In this case, county auditors receive much more latitude than their municipal counterparts. Whereas 82% of the counties responded that the auditor set the priorities and nearly half (46%) cited the auditor as providing the appropriate access approval, only 27% of the municipal auditors perceived that they set their own priorities and only 19% indicated that the auditor could provide the staff with access approval to the records of an activity under review. The remaining cases cited various individuals or groups that enter into the priority setting and access process, but the limiting of the auditors individual ability to go where he or she is needed, when he or she is needed remains the same.

A relatively subjective question concerning the acceptance of audit findings and recommendations was asked of the County and Municipal auditors in the survey questionnaire. Both groups strongly indicated that, in



general, the auditee accepted the findings and conclusions they presented. Further, although this does not indicate that the audit organizations are recognized within their governmental units, very few in either group indicated that their office was utilized to train prospects for higher level office. Overall, the responses demonstrate a growing independence and stature of the internal audit activity in local government. However, the full force will not be felt until both top management and those in critical line positions in government recognize the benefits to be gained from instilling a truly independent attitude in their audit units.

### c. Objectivity

When addressing the objectivity of a governmental audit unit, both segregation of duties and organizational status play an important role. As the author has shown, neither of these qualities is evident to a great degree in either the County or Municipal governments surveyed. It would be difficult to be objective if the auditor was reviewing his or her own work, as is the prevalent situation, and if the auditor was not situated properly within the organizational structure. However, this section will continue the analysis presented in these two critical areas by providing a discussion on conflicts of interest, the expression of opinions and the utilization of the auditor in areas other than auditing.

Conflicts of interest were thoroughly discussed in Chapter III in conjunction with the GAO Standards for Audit, while the State of California's requirement to maintain conflict of interest statements was presented in Chapter V. Since the maintenance and update of these statements is state mandated the responding auditors in both





groups should have unanimously indicated compliance. Yet, this was not the case. This thesis has previously listed the dangers in this area, and governmental auditors are extremely susceptible because of their often delicate political position. Although the filing of statements to fulfill the state requirement would do nothing to perpetuate a conflict free organization, a thorough investigation in this area could eliminate any possible problems in the future. Thus, in the author's opinion, county and municipal auditors have enough internally generated organizational impediments to objectivity without allowing personal and external impairments to further bias their opinions, conclusions and judgements.

The expression of an opinion based upon the evidencial matter gathered during an audit is an essential tenet of the GAO audit standards. The rendering of opinions on the performance of a reviewed entity is a specific requirement of the expanded scope standards being evaluated in this study and also a necessary requirement to evaluate an auditors' objectivity. However, as shown previously, local governments follow the American Institute of Certified Public Accountants (AICPA) standards which dictate the rendering of opinions only in Level I, Financial and Compliance audits. In reviewing the findings of this survey, the author found that 89% of the responding auditors rendered opinions on all their audits. However, as one will see later in this chapter, only a small percentage of these auditors complete any type of audit other than Financial and Compliance. Thus, merely stating this fact does not indicate whether the GAO standards are being followed in deference to the AICPA standards of audit.

Relating back to the section on independence, the author noted that the survey findings indicated a





majority of both County and Municipal auditors performing in a line or an accounting function while serving in their office. At that point, this fact served to further delineate the lack of an appropriate level of task separation. Obviously, this also has a significant impact on the auditors objectivity. A few responding municipal auditors indicated that serving in any capacity outside the office of Auditor was forbidden under their city's internal control procedures. Controls of this type are in place to preclude any indication that an individual could in any way be influenced in his or her decision making process. This type of in place control would also serve to lessen the impact of the auditors being able to serve in various offices concurrently. Sawyer stresses the need for perceived independence; the standards controlling the quality of governmental audit work stress the need for objectivity in the performance of an audit and in the publication of audit findings and conclusions. In the author's opinion, neither situation is prevalent to a great degree in the county and municipal levels of government in the State of California.

#### 4. Competence

Internal auditors should be competent in planning and conducting their audit assignments. Additionally, they should be able to collect, analyze, interpret, communicate and document information to support their audit judgements and conclusions. Further, it is also to their advantage to maintain a close liason with the audited activity to assure that follow-up action has been initiated on the reported audit findings. Thus, governmental auditors should meet the following specific standards:

1. Audit work should be properly documented in the audit working papers;
2. Working papers should contain appropriate evidence of follow-up and disposition of deficiency findings; and,



3. Audit reports should be supported by competent, sufficient and relevant evidence in the working papers. [7]

Again, these measures, together with the survey findings, will be utilized in the following discussions concerning the level of audit competence evident at the County and Municipal levels of government in the State of California.

An indicator utilized to determine the scheduling and planning capability of the surveyed auditors was their ability to complete the audits they scheduled. Only a slight majority answered affirmatively to this question, that is, that they and their staff were able to complete all scheduled audits. However, an earlier question asking for the approximate number of scheduled and completed audits indicated an even greater disparity; Table XIX presents data that supports the position that a greater percentage are not able to meet their audit commitments. It must be understood, however, that most audits in the public sector are required by state or federal law and local statute and that workload pressure and staffing deficiencies can make it difficult to perform all needed audits. In fact, many auditors commented that their offices were from three to five years behind in the completion of required Financial and Compliance audits. Although this seems to indicate improper planning, the findings do not support this position. It is much more believable that internal and external pressures are evident that negate the best laid plans of the auditing units.

The survey findings suggest that accepted reporting procedures are utilized by both audit groups. Audit reports identifying weaknesses and recommendations for improvement are routinely issued; the noteworthy accomplishments of the auditee are included in the report when applicable; summaries of audit findings are regularly included as part



of the final audit report; the auditors generally meet with the audited activity to discuss their findings and recommendations; and, the expressed reactions and follow-up or corrective action initiated are often included in the final audit reports. These practices indicate a willingness on the part of the audit units involved to help promote action on their recommendations for improvement and to project a professional, yet helpful attitude to the auditee. These procedures have the positive impact of tending to make the audit unit and its responsibilities more palatable to the audited activities and also suggest that auditors utilize every technique available to communicate their findings, judgements and conclusions in a constructive manner.

Based upon the findings, it appears that the auditee is given the primary responsibility to report follow-up and corrective action initiated after the completion of an audit. This leads directly to substantial delays in the publication of the final audit report and tends to reinforce a non-constructive attitude on the part of the audited entity. Since no timeframes are established, there is a high delinquency rate in the issuance and receipt of the auditees expressed opinions. Thus, action on the recommendations for improvement are delayed and the immediacy of the problems evident in the audited activity loses much of its impact.

All auditors responding to the survey periodically reviewed the working papers compiled by their staff. It is understood that this review is probably conducted in conjunction with a review of the final audit report draft. Thus, it appears that the auditors can effectively substantiate the findings, judgements and conclusions that are issued to the auditee since delays are the province of the auditee and not the auditing entity.





Finally, the report's distribution can be utilized to indicate the degree of report dissemination as well as the overall acceptability of the audit units work. The findings suggest that municipal reports receive a greater audience than do county audit reports. All interested and involved parties are routinely routed a copy of the final report and it is hoped that the results contained therein are utilized to aid managers in other functional areas in their quest for optimal performance.

## 5. Compliance

The thrust of this thesis revolves around the degree of compliance evident in the Counties and Municipalities of the State of California with the GAO expanded scope Standards for Audit and, if applicable, the reasons for non-compliance. In addition to most of the general standards, the bulk of the questions asked of auditing practitioners concerned the examination, evaluation and reporting standards. However, the author specifically desired to determine the degree of performance of Level II, Economy and Efficiency, and Level III, Program Results, audits.

A study conducted by the GAO in 1974 covering 15 states indicated that auditors felt limited by the resources they could allocate to Level II and Level III audits. In particular, they felt that with an adequate staff and the legal authority they could devote considerably more time to these areas. At that time, state auditors were devoting only 8% of their time to Economy and Efficiency audits and only 3% to Program Results audits. They overwhelmingly cited the need for additional staff, the need for additional training and the need to identify specific program objectives as the solutions to expanding the scope of their audits. [10:12-13]



Since this previous study, the situation has not changed considerably. The survey results indicate that County and Municipal auditors in the State of California spend only 7% of their time conducting Level II audits and only 5% of their time performing Level III audits. It should be noted, however, that these are averages; a few counties and municipalities indicated substantially higher Level II and III audit performance figures, but the vast majority of respondents indicated that only Financial and Compliance audits were accomplished by their units.

The need for additional staff, funding and training were cited as the most serious impediments to the performance of full scope audits. These findings coincide with those of the eight year old GAO report and suggest that the situation has remained virtually unchanged. Further, another impediment that received a substantial response was the lack of top management support. As mentioned previously, the actions of the auditing unit will not be taken too seriously if the senior government officials do not place their full support behind the efforts of their auditing units.

The final question on the survey provided a space for comment concerning the growth and development potential of public sector auditing. The results were similar to the findings above, in that lack of funding and lack of adequate, trained staff were consistently cited as impediments to the future growth potential of auditing in government. An additional facet to the problem, however, was evident in this regard. Numerous practitioners cited a lack of top managements' understanding of the role and benefits of internal auditing as a significant impairment to their continued growth. In all, the indicated restrictive causal factors are determining the direction and scope of



governmental auditing's future. Without adequate funding, training, staffing, understanding and support there seems little hope that auditors can strengthen their positions and improve the quality of their product.

### C. CONCLUSIONS

In view of the preceding analysis of the survey data, the following conclusions relating to the purpose and objectives of this thesis are provided:

1. The Counties and Municipalities in the State of California do not fully comply with the GAO expanded scope audit standards; specifically, they do not conduct Level II and Level III audits with any evident regularity; and
2. The predominant reasons for non-compliance are lack of funding, lack of an adequate, trained staff, lack of top management support and the lack of top management's understanding of the role and benefits of internal auditing.

Although the Counties and Municipalities in the State of California comply with most of the accepted GAO general, examination, evaluation and reporting standards, the above considerations are made only with respect to their audit scope. It is apparent that the expanded scope standards issued by the GAO in 1972 to provide guidance to public sector auditors requires the full force of law to be implemented in their entirety. Accepted procedures aside, and despite the fact that there are benefits that can accrue to local governments from audits of efficiency, economy and program effectiveness, these type audits are not widely performed by local governments.

### D. RECOMMENDATIONS

In view of the research findings, as well as the author's conclusions drawn from the analyzed data, the following recommendations are provided to effect the





continued growth and development of internal auditing in the Counties and Municipalities of the State of California:

1. Enact legislation requiring compliance with the GAO expanded scope audit standards;
2. Where not already being accomplished, separate the internal auditing unit from all other functional areas of government;
3. Elect all county and municipal auditors; thus maintaining the individual's constituency as the operative reporting senior;
4. Elect an individual for the office of Auditor only; eliminate the subsidiary duties currently being performed;
5. Provide an adequate budget for the continuance of the auditing function within the serviced community; include provisions for an adequate staff to handle the expected workload and provisions to meet the units continuing training requirements;
6. Provide management indoctrination and training on the role and benefits of internal auditing in local government; and,
7. Include in existing legislation updated and current qualification standards for the Office of Auditor and prospective audit staff members.





## APPENDIX A

### AUDITING STANDARDS AND PROCEDURES: 1963

#### General Standards

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. In all matters relating to the assignment an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

#### Standards of Field Work

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

#### Standards of Reporting



1. The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an over-all opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

Reprinted from: Committee on Auditing Procedure, Auditing Standards and Procedures (New York: American Institute of Certified Public Accountants, Statements on Auditing Procedures No. 33, 1963), pp. 15-16.



## APPENDIX B

### AUDITING STANDARDS AND PROCEDURES: 1972

#### General Standards

1. The full scope of an audit of a governmental program, function, activity, or organization should encompass:
  - a) An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
  - b) A review of efficiency and economy in the use of resources.
  - c) A review to determine whether desired results are effectively achieved.
2. The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.
3. In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.
4. Due professional care is to be used in conducting the audit and in preparing related reports.

#### Examination and Evaluation Standards

1. Work is to be adequately planned.
2. Assistants are to be properly supervised.
3. A review is to be made of compliance with legal and regulatory requirements.
4. An evaluation is to be made of the system of internal control to assess the extent it can be relied upon to ensure accurate information, to ensure compliance





with laws and regulations, and to provide for efficient and effective operations.

5. Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditor's opinions, judgments, conclusions and recommendations.

### Reporting Standards

1. Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others responsible or authorized to receive such reports. Unless restricted by law or regulation, copies should also be made available for public inspection.
2. Reports are to be issued on or before the dates specified by law, regulation or other arrangement and, in any event, as promptly as possible so as to make the information available for timely use by management and by legislative officials.
3. Each report shall:
  - a) Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.
  - b) Present factual matter accurately, completely and fairly.
  - c) Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.
  - d) Include only factual information, findings, and conclusions that are adequately supported by



enough evidence in the auditor's working papers to demonstrate or prove, when called upon, the bases for the matters reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent necessary to make a convincing presentation.

- e) Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
- f) Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented in balanced perspective, recognizing any unusual difficulties or circumstances faced by the operating officials concerned.
- g) Identify and explain issues and questions needing further study and consideration by the auditor or others.
- h) Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.
- i) Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions should be reviewed with such officials. When possible, without undue delay, their views should be



obtained in writing and objectively considered and presented in preparing the final report.

j) Clearly explain the scope and objective of the audit.

k) State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.

4. Each audit report containing financial reports shall:

a) Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in accordance with generally accepted accounting principles (or with any other accounting principles applicable to the organization, program, function or activity audited), applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.

b) Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including instances of non-compliance, and material changes in accounting policies and procedures, along with their effect on the financial reports, shall be explained in the audit report.



Reprinted from: Standards for Audit of Governmental Organizations, Programs, Activities and Functions, Office of the Comptroller General of the United States Pamphlet 2000-00110, 1972.





APPENDIX C

QUESTIONNAIRE

1. What is the population of the County/Municipality you serve?  
(check one)

- a. 0 - 10,000  
----- b. 10,001 - 50,000  
----- c. 50,001 - 100,000  
----- d. 100,001 - 500,000  
----- e. over 500,000

2. Are you an Elected or an Appointed official of your  
County/Municipality? (check one)

- a. ELECTED ----- b. APPOINTED

If APPOINTED, by whom was the appointment made?

-----

3. Please indicate below the length of your term in office  
and how long you have served in your current capacity.

- a. TERM ----- b. SERVED

4. From the list below, please indicate the positions  
you currently hold within your County/Municipality.

- a. Auditor  
----- b. Recorder  
----- c. Controller  
----- d. Clerk  
----- e. Other (specify) -----

5. From the list below, please indicate the professional  
credentials you hold:

- a. Certified Internal Auditor (CIA)  
----- b. Certified Public Accountant (CPA)  
----- c. Chartered Accountant  
----- d. Other (specify) -----



-----

- \_\_\_\_\_ a. SCHEDULED \_\_\_\_\_ B. COMPLETED

- | Total<br>Number | Degrees |     | Number of |       |
|-----------------|---------|-----|-----------|-------|
|                 | BS/BA   | MBA | CPA's     | CIA's |
| -----           | ---     | --- | -----     | ----- |
| -----           | ---     | --- | -----     |       |
| -----           |         |     |           |       |

- a. Program Budget  
----- b. Line Item Budget  
----- c. Other (specify) -----

- | A. Type of Audit        | Percent of Time |
|-------------------------|-----------------|
| Entity Audits           | -----           |
| Functional Audits       | -----           |
| Special Reviews         | -----           |
| Investigative Inquiries | -----           |
| Cther                   |                 |

I financial and compliance \_\_\_\_\_

II efficiency and economy \_\_\_\_\_

III program results \_\_\_\_\_

.....

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----- YES ----- NO

12. Do you maintain, and periodically update, written Conflict of Interest Statements for your audit staff?

----- YES ----- NO

13. Does your office operate with its own budget appropriation?

----- YES ----- NO

If no, from which governmental department does your office receive its funding?

-----

14. Does your County provide a formal training program for you and your staff auditors?

----- YES ----- NO

15. From which of the following individuals or groups must a staff auditor seek access approval for the data pertinent in the evaluation of an activity under review?

----- a. Auditor

----- b. Legislative Bcdy

----- c. the Audited activity

----- d. Other (specify) -----

16. Does your office:

\_\_\_YES \_\_\_NO a. maintain written goals and objectives?

\_\_\_YES \_\_\_NO b. publish a policy and procedures manual?

\_\_\_YES \_\_\_NO c. utilize tailored audit programs?

\_\_\_YES \_\_\_NO e. publish standards of field work?

17. Please rank each of the following qualification standards in their order of importance to you in determining the eligibility of prospective audit staff members:

----- a. Corporate accounting experience

----- b. College degree in related field

----- c. CPA/CIA or other professional credentials

----- d. Public accounting experience

----- e. Internal auditing experience

18. Which of the following statements best describes the historic action of your budget or budget share? (check one)

----- a. growing steadily

----- b. remaining constant





----- c. decreasing

19. Do you and your staff auditors:

\_\_\_YES \_\_\_NO a. Attend professional seminars?

\_\_\_YES \_\_\_NO b. Attend ADP courses and seminars?

\_\_\_YES \_\_\_NO c. Attend college to continue your education?

\_\_\_YES \_\_\_NO d. Attend classes to secure certification as a CPA or CIA?

20. Are you, or members of your staff, called upon to provide assistance on a temporary basis to a line or accounting function?

----- YES ----- NO

21. From the following list, check the areas in which you or your staff could most benefit from additional training:

----- a. Auditing procedures and standards

----- b. Accounting systems review

----- c. Automatic Data Processing controls

----- d. Knowledge of applicable laws and regulations

----- e. Resource management

----- f. Identifying governmental program objectives.

22. Does your office make use of consultants in the completion of scheduled audits?

----- a. YES ----- b. NO

23. Based on your experience with staff turnover, would you say that your office is recognized and used as a training ground for higher level governmental positions?

----- YES ----- NO

24. By whom is the performance of the audit staff evaluated:

a. internally? -----

b. externally? -----

25. Please indicate below the appropriate individual or group that sets audit priorities for your office:

----- a. Auditor

----- b. Legislative Body

----- c. Other (specify) -----



26. Which of the following best describes the format of your audit programs?
- a. Detailed Audit Steps
- b. Broad and general with additional steps designed on the job.
27. Are you and your staff able to cover the scheduled audits of facilities and functions within the required time cycle?
- YES                      ----- NO
28. Do you and your staff become involved in reviews of new systems (accounting, control, ADP, etc.) early in their development stage?
- YES                      ----- NO
29. Are reports issued identifying weaknesses and recommendations for improvement?
- YES                      ----- NO
30. From your viewpoint, please rank each of the following probable impediments to the performance of full scope audits: (use the scale shown below by checking the appropriate blank)
- very restrictive  
| restrictive, but not debilitating  
| not a factor  
|
- --- --- a. Need for additional staff
- --- --- b. Need for additional funding.
- --- --- c. Need for additional training.
- --- --- d. Statutory requirements to perform financial. and compliance (Level I) audits.
- --- --- e. Overlap of audit responsibilities with other levels of government.
- --- --- f. Requirements of legislative initiatives. (e.g. those pertaining to grants-in-aid and OMB Circular A-102)
- --- --- g. Bond Rating requirements
- --- --- h. Lack of Top Management Support
31. Do your audit reports regularly include the noteworthy accomplishments of the auditee?
- YES                      ----- NO



32. From the following list, check the statement(s) that best describe(s) the extent of your automatic data processing audit coverage:
- a. Audit "around" the computer.
  - b. Audit controls vice input and output.
  - c. Review departmental operations and controls.
  - d. Audit specific applications on request.
  - e. Audit "through" the computer.
  - f. Do not conduct ADP audits
33. At the conclusion of an audit assignment, do you and your auditors meet with the representatives of the audited organization and discuss the findings and recommendations before issuing the final audit?
- YES                      ----- NO
34. Is it your practice to include in the final audit report the expressed reactions of the audited organization and some indication of the follow-up and corrective action they intend to initiate?
- YES                      ----- NO
35. Are summaries of audit findings included with the final audit report?
- YES                      ----- NO
36. Is an overall opinion given in the report based upon the audit findings?
- YES                      ----- NO
37. After the release of an audit report, is the primary responsibility for reporting the follow-up and corrective action assigned to: (check one)
- a. Your office, or
  - b. The audited organization.
  - % If the responsibility is with the auditee, what percentage respond within established timeframes?
- What is the main cause for delays in the release of final audit reports?
- 
38. Do you periodically review the working papers compiled by your staff?
- YES                      ----- NO



39. Are the audit findings generally accepted by the auditee?

----- YES ----- NO

When recommendations for improvement are made, are they generally accepted by the auditee?

----- YES ----- NO

40. From the list below, please indicate those who generally receive your audit reports:

----- a. Media representatives

----- b. Chief Executive Officers

----- c. Legislative bodies

----- d. Higher Units of government

----- e. Chief Fiscal Officers

----- f. Controllers

----- g. Other (specify) -----

In your view, what is the most serious impediment to the growth and development of internal auditing at the County or Municipal level of Government?

-----  
-----





Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
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\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Yes    No    Do you wish to receive copies of the summarized  
survey results?

\_\_\_\_\_ How many copies?

Please indicate below the address to which the  
summarized results should be mailed:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_



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